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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

ROBERT "BOB" BURNS – Chairman  
BOYD DUNN  
SANDRA D. KENNEDY  
JUSTIN OLSON  
LEA MÁRQUEZ PETERSON

IN THE MATTER OF THE APPLICATION OF  
SOUTHWEST GAS CORPORATION FOR THE  
ESTABLISHMENT OF JUST AND REASONABLE  
RATES AND CHARGES DESIGNED TO REALIZE  
A REASONABLE RATE OF RETURN ON THE  
FAIR VALUE OF THE PROPERTIES OF  
SOUTHWEST GAS CORPORATION DEVOTED  
TO ITS ARIZONA OPERATIONS.

DOCKET NO. G-01551A-19-0055

DECISION NO. 77850

**OPINION AND ORDER**

DATE OF HEARING:

November 19, 2019 (Procedural Conference); February 3, 2020 (Procedural Conference); February 18, 2020 (Public Comment); April 1, 2020 (Procedural Conference); May 7, 2020 (Procedural Conference); May 29, 2020 (Procedural Conference); June 19, 2020 (Procedural Conference); June 23, 2020 (Prehearing Conference); June 30 – July 2 and July 6 – July 10, 2020 (Hearing); September 12, 2020 (Public Comment); November 9, 2020 (Public Comment); and November 14, 2020 (Public Comment)

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Scott M. Hesla

APPEARANCES:

Ms. Catherine M. Mazzeo, Mr. Kyle Stephens, and Mr. Andrew Hill, on behalf of Southwest Gas Corporation;

Arizona Corporation Commission

**DOCKETED**

**DEC 17 2020**

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Mr. Richard Gayer, *in pro persona*;

Mr. Craig A. Marks, CRAIG A. MARKS PLC, on behalf of Arizona Grain, Inc.;

Mr. Robert J. Metli, MUNGER CHADWICK & DENKER PLC, on behalf of Arizona Grain, Inc.;

Mr. Michael Patten, SNELL & WILMER LLP, on behalf of NatureSweet USA, LLC;

Mr. Steve Wene, MOYES SELLERS & HENDRICKS LTD, on behalf of the City of Bullhead City;

Mr. Daniel W. Pozefsky, Chief Counsel, on behalf of Residential Utility Consumer Office; and

Ms. Bridget Humphrey and Mr. Robert W. Geake, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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**BY THE COMMISSION:**

This matter involves the amended rate application of Southwest Gas Corporation (“SWG” or “Company”) filed with the Arizona Corporation Commission (“Commission”) for an adjustment to its rates and charges for gas utility service provided to its customers in Arizona. In addition, SWG requests approval to: implement a program and associated cost recovery mechanism to replace 7000/8000 Driscopipe; continue its Customer Owned Yard Line (“COYL”) replacement program and associated cost recovery mechanism; continue its Vintage Steel Pipe (“VSP”) replacement program and associated cost recovery mechanism; continue its revenue decoupling mechanism referred to as the Delivery Charge Adjustment Provision (“DCA”); incorporate Renewable Natural Gas (“RNG”) into its gas supply portfolio; and revise various tariffs. The amended application was based upon adjusted test year (“TY”) revenue and expenses for the Company’s jurisdictional operations in Arizona during the twelve months ending January 31, 2019.

Intervention in this matter was granted to the Residential Utility Consumer Office (“RUCO”), Richard Gayer, Arizona Grain, Inc. (“Arizona Grain”), NatureSweet USA, LLC (“NatureSweet”), and the City of Bullhead City (“Bullhead City”).

**DISCUSSION****I. Procedural History**

On March 18, 2019, SWG filed a Notice of Intent to File a Rate Case Application advising the Commission that the Company would be filing a rate case application on or about May 1, 2019.

On May 1, 2019, SWG filed an application for an increase in rates for utility service provided in Arizona. With its application, SWG filed supporting schedules and the direct testimony of Matthew D. Derr, Byron C. Williams, Kevin M. Lang, John R. Olenick, Carla D. Ayala, Kristien M. Tary, Dane A. Watson, Randi L. Cunningham, Theodore K. Wood, and Robert B. Hevert.

On May 31, 2019, the Commission’s Utilities Division Staff (“Staff”) filed a Letter of Sufficiency stating that SWG’s application had met the sufficiency requirements outlined in Arizona Administrative Code (“A.A.C.”) R14-2-103, and classifying the Company as a Class A utility.

On June 7, 2019, SWG filed additional rate case schedules in support of its application.

1 On June 25, 2019, Staff filed a Proposed Procedural Schedule stating that Staff and SWG have  
2 discussed and agreed to a procedural schedule.

3 On June 26, 2019, a Procedural Order was issued scheduling a hearing in this matter to  
4 commence on February 17, 2020, and establishing various other procedural requirements and  
5 deadlines.

6 On September 10, 2019, SWG filed Certification of Mailing and Publication, certifying that  
7 public notice of the hearing date was mailed to all customers of record between July 9 and August 6,  
8 2019; was posted in a prominent location on the Company's website on or before August 10, 2019; and  
9 was published in eight newspapers of general circulation in the Company's service territories between  
10 August 8 and 10, 2019.

11 On September 12, 2019, a Procedural Order was issued rescheduling the hearing to commence  
12 on February 18, 2020,<sup>1</sup> and directing the Company to issue notice informing customers that the hearing  
13 date had been rescheduled.

14 On October 24, 2019, the Company filed a Supplement to Application of Southwest Gas  
15 Corporation to amend its application to include additional post-test year plant ("PTYP") associated  
16 with the Company's COYL and VSP replacement programs.

17 On October 30, 2019, Arizona Grain filed a Motion to Reject Supplement to Application.

18 On November 4, 2019, the Company filed an Opposition to Arizona Grain's Motion to Reject  
19 Supplement to Application.

20 On November 5, 2019, RUCO filed a Response to Arizona Grain's Motion to Reject  
21 Supplement to Application and a Request for a Procedural Conference.

22 On November 6, 2019, a Procedural Order was issued scheduling a procedural conference to  
23 commence on November 14, 2019, to discuss Arizona Grain's motion as well as the Company's  
24 amendment to its application.<sup>2</sup>

25 On November 8, 2019, Staff filed a Response to Arizona Grain's Motion to Reject Supplement  
26 to Application and Proposed Procedural Schedule.

27 <sup>1</sup> The hearing was rescheduled because February 17, 2020, was President's Day, a Holiday observed by the State of Arizona.

28 <sup>2</sup> Due to a system-wide technology outage at the Commission's offices on November 14, 2019, the procedural conference was rescheduled to commence on November 19, 2019.

1 On November 12, 2019, Arizona Grain filed a Reply in Support of its Motion to Reject  
2 Supplement to Application.

3 On November 19, 2019, the procedural conference was held as scheduled, with SWG, Arizona  
4 Grain, NatureSweet, RUCO, and Staff appearing through counsel.<sup>3</sup> At that time, it was determined  
5 reasonable and appropriate to allow the parties additional time to review and process the amendment  
6 to SWG's application, and the parties agreed upon modifications to the procedural schedule.

7 On November 22, 2019, SWG filed schedules summarizing the revenue and bill impacts  
8 associated with the amendment to its application.

9 On November 26, 2019, a Procedural Order was issued rescheduling the hearing in this matter  
10 to commence on April 20, 2020, and establishing various other procedural requirements and deadlines.  
11 Additionally, it was determined that additional notice was required to notify customers of the estimated  
12 bill impacts associated with the amended application.

13 On November 27, 2019, SWG filed Amended Testimony, Schedules, and Workpapers in  
14 support of its amended application. With its filing, SWG included the amended direct testimony of  
15 Byron C. Williams and Randi L. Cunningham.

16 On January 28, 2020, Arizona Grain filed the direct testimony of J. Randall Woolridge and  
17 Scott J. Rubin; RUCO filed the direct testimony of Jeffrey Michlik and John Cassidy; and Staff filed  
18 the direct testimony of Alexander I. Igwe, Alan Borne, and Phillip Metzger.

19 On the same date, Staff filed a Request for Extension of Time to File Direct Testimony  
20 requesting an extension of time to file the direct testimony for two of its witnesses, Ralph C. Smith and  
21 David C. Parcell, and an extension of time to file its direct testimony relating to rate design and cost of  
22 service.

23 On January 29, 2020, SWG filed a Response to Staff's Request for Extension of Time to File  
24 Direct Testimony stating that it does not oppose Staff request, provided that the Company is afforded  
25 a corresponding extension of time to file its rebuttal testimony.

26 On January 30, 2020, RUCO filed a Request for Procedural Conference stating that while  
27

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28 <sup>3</sup> Mr. Gayer did not enter an appearance.

1 RUCO did not initially object to Staff's request for an extension, RUCO recognized that there were  
2 potential issues involved with modifying the procedural schedule. On the same date, Staff filed a  
3 Proposed Schedule for the Filing of PreFiled Testimony.

4 Later, on January 30, 2020, a Procedural Order was issued scheduling a procedural conference  
5 to commence on February 3, 2020, for the purpose of discussing modifications to the existing  
6 procedural schedule.

7 On February 3, 2020, the procedural conference was held as scheduled, with SWG, Arizona  
8 Grain, NatureSweet, RUCO, and Staff, appearing through counsel.<sup>4</sup> At that time, the parties agreed to  
9 modify the deadlines for filing testimony.

10 On February 4, 2020, by Procedural Order, the modified procedural schedule agreed upon by  
11 the parties was adopted.

12 On February 5, 2020, Staff filed the direct testimony of Ralph C. Smith and David C. Parcell.

13 On February 10, 2020, SWG filed a Certification of Mailing and Publication, certifying that  
14 public notice of the rescheduled April 20, 2020, hearing date was mailed to all customers of record  
15 between January 1 and February 6, 2020; posted in a prominent location on the Company's website on  
16 or before January 15, 2020; and published in nine newspapers of general circulation in the Company's  
17 service territories between December 18, 2019, and January 15, 2020.

18 On February 18, 2020, a public comment session was held as scheduled, with the Company  
19 appearing through counsel, and Mr. Gayer appearing pro se.<sup>5</sup> Mr. Gayer and one customer of SWG  
20 presented public comment.<sup>6</sup>

21 On February 19, 2020, Arizona Grain filed the direct testimony (on rate design and cost of  
22 service) of Scott J. Rubin; RUCO filed the direct testimony (on rate design and cost of service) of  
23 Jeffrey Michlik; and Staff filed the direct testimony (on rate design and cost of service) of Ralph C.  
24 Smith, Candrea Allen, Gurudatta Belavadi, Richard B. Kuprewicz, and Patrick LaMere.

25 On March 11, 2020, SWG filed the rebuttal testimony of Theodore K. Wood, Robert B. Hevert,

26 <sup>4</sup> Mr. Gayer did not enter an appearance.

27 <sup>5</sup> None of the other parties entered appearances.

28 <sup>6</sup> Mr. Gayer stated that his deteriorating health would likely prevent him from further participating in this matter as an  
intervenor. As a result, Mr. Gayer requested permission to present public comment. Due to the extenuating circumstances,  
and with no objection from the Company, Mr. Gayer was granted permission to provide public comment.



1 Matthew D. Derr, Bryon C. Williams, Todd A. Shipman, Timothy A. Simon, Esq., Kevin M. Lang,  
2 Keith Bacon, John R. Olenick, Sharon Braddy McKoy, A. Brooks Congdon, and Randi L.  
3 Cunningham.

4 On March 24, 2020, Staff filed a Request for a Procedural Conference, requesting that a  
5 telephonic procedural conference be held to discuss the best way to proceed with the current procedural  
6 schedule in light of the precautions being undertaken to address the COVID-19 pandemic.

7 On March 26, 2020, by Procedural Order, a telephonic procedural conference was scheduled to  
8 commence on April 1, 2020.

9 On April 1, 2020, the telephonic procedural conference was held as scheduled, with the  
10 Company, Arizona Grain, NatureSweet, Bullhead City, RUCO, and Staff appearing through counsel.<sup>7</sup>  
11 At that time, the parties discussed potential modifications to the procedural schedule in light of the  
12 COVID-19 pandemic. The parties agreed to continue the hearing and convene a procedural conference  
13 on May 7, 2020, to assess the status of the COVID-19 pandemic and the possibility of resetting the  
14 hearing to commence towards the end of May, 2020. In addition, RUCO requested a one-week  
15 extension of time to file its surrebuttal testimony, which was unopposed by the parties.

16 On April 2, 2020, by Procedural Order, the hearing was continued, a telephonic procedural  
17 conference was scheduled for May 7, 2020, and other procedural deadlines were set.

18 On April 10, 2020, Arizona Grain filed the surrebuttal testimony of J. Randall Woolridge and  
19 Scott J. Rubin; RUCO filed the surrebuttal testimony of Jeffrey Michlik and John Cassidy; and Staff  
20 filed the surrebuttal testimony of David C. Parcell, Alexander I. Igwe, Richard B. Kuprewicz, Ralph  
21 C. Smith, Candrea Allen, and Patrick LaMere.

22 On April 21, 2020, SWG filed the rejoinder testimony of Keith Bacon, Sharon Braddy McKoy,  
23 A. Brooks Congdon, Matthew D. Derr, Robert B. Hevert, Theodore K. Wood, Randi L. Cunningham,  
24 John R. Olenick, Timothy A. Simon, Esq., Kevin M. Lang, and Bryon C. Williams.

25 On May 7, 2020, the telephonic procedural conference was held as scheduled, with the  
26 Company, Arizona Grain, NatureSweet, Bullhead City, RUCO, and Staff appearing through counsel.<sup>8</sup>

27 \_\_\_\_\_  
28 <sup>7</sup> Mr. Gayer did not enter an appearance.

<sup>8</sup> Mr. Gayer did not enter an appearance.

1 At that time, the parties discussed the status of the COVID-19 pandemic and the feasibility of resetting  
2 the hearing dates. Based on the discussion of the parties, it was determined reasonable and appropriate  
3 to reset the hearing in this matter to commence at the end of June, 2020. It was further determined  
4 reasonable and appropriate to set a telephonic procedural conference at the end of May, 2020, to  
5 reassess the status of the COVID-19 pandemic and determine whether the hearing dates reset therein  
6 should proceed as scheduled.

7 On May 11, 2019, a Procedural Order was issued resetting the hearing in this matter to  
8 commence on June 30, 2020; resetting the prehearing conference to commence on June 23, 2020; and  
9 directing the Company to notify customers of the reset hearing date.

10 On May 28, 2020, SWG filed a Certification of Public Notice of Hearing, certifying that public  
11 notice of the reset hearing date was mailed to its customers between May 29 and June 26, 2020, and  
12 was posted in a prominent location on SWG's website on or before May 22, 2020.

13 On May 29, 2020, a telephonic procedural conference was held as scheduled, with the  
14 Company, Arizona Grain, NatureSweet, RUCO, and Staff appearing through counsel.<sup>9</sup> At that time,  
15 the parties proposed a plan to work together to test the practicality of utilizing videoconferencing  
16 platforms to convene a remote hearing in light of the COVID-19 pandemic.<sup>10</sup> Based on the discussion  
17 among the parties, it was determined reasonable and appropriate to preserve the existing hearing dates  
18 and schedule another procedural conference to commence on June 19, 2020, to discuss the viability of  
19 the videoconferencing platforms tested by the parties.<sup>11</sup>

20 On June 1, 2020, by Procedural Order, a telephonic procedural conference was scheduled for  
21 June 19, 2020.

22 On June 19, 2020, the procedural conference was held as scheduled,<sup>12</sup> with SWG, Arizona  
23 Grain, NatureSweet, Bullhead City, RUCO, and Staff appearing through counsel.<sup>13</sup> At that time, the  
24 parties agreed to proceed with the hearing utilizing a videoconference format.

25  
26 <sup>9</sup> Bullhead City and Mr. Gayer did not enter appearances.

27 <sup>10</sup> The parties proposed to begin testing videoconferencing capabilities on June 4, 2020.

28 <sup>11</sup> The videoconferencing platforms tested were Cisco WebEx and Microsoft TEAMS.

<sup>12</sup> The procedural conference was conducted via videoconference.

<sup>13</sup> Mr. Gayer did not enter an appearance.

1 On June 23, 2020, the prehearing conference was held as scheduled,<sup>14</sup> with SWG, Arizona  
 2 Grain, NatureSweet, Bullhead City, RUCO, and Staff appearing through counsel.<sup>15</sup> At that time, the  
 3 parties discussed witness scheduling and the possibility of stipulating to the admission of uncontested  
 4 prefiled testimony.

5 On June 30, 2020, the hearing was convened as scheduled,<sup>16</sup> before a duly authorized  
 6 Administrative Law Judge (“ALJ”) of the Commission, with SWG, Arizona Grain, RUCO, and Staff  
 7 appearing through counsel.<sup>17</sup> SWG presented the witness testimony of Theodore K. Wood, Robert B.  
 8 Hevert, Matthew D. Derr, Bryon C. Williams, Todd A. Shipman, Timothy A. Simon, Kevin M. Lang,  
 9 Keith Bacon, John R. Olenick, Sharon Braddy McKoy, A. Brooks Congdon, and Randi L.  
 10 Cunningham; Arizona Grain presented the witness testimony J. Randall Woolridge and Scott J. Rubin;  
 11 and Staff presented the witness testimony of David C. Parcell, Ralph C. Smith, Alexander I. Igwe,  
 12 Richard B. Kuprewicz, and Patrick LaMere. In addition, the parties stipulated to the admission of the  
 13 prefiled testimony of Dane A. Watson<sup>18</sup> and Carla Ayala<sup>19</sup> on behalf of SWG; and Gurudatta  
 14 Belavadi,<sup>20</sup> Candrea Allen,<sup>21</sup> Alan Borne,<sup>22</sup> and Phillip Metzger<sup>23</sup> on behalf of Staff. During the  
 15 hearing, Arizona Grain made an oral motion to compel SWG to provide an updated rate case Schedule  
 16 D to reflect the Company’s current capital structure, which was taken under advisement pending the  
 17 submission of written briefs addressing the motion to compel. At the conclusion of the hearing, the  
 18 matter was taken under advisement pending the submission of closing briefs and final schedules.<sup>24</sup>

19 On July 8, 2020, by Procedural Order, a telephonic public comment session was scheduled for  
 20 September 21, 2020, and the Company was directed to publish and provide customer notice of that  
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23 <sup>14</sup> The prehearing conference was conducted via videoconference.

24 <sup>15</sup> Mr. Gayer did not enter an appearance.

25 <sup>16</sup> The hearing was conducted via videoconference.

26 <sup>17</sup> NatureSweet and Bullhead City were excused from participating in the hearing at the requests of their respective counsel.  
 27 Mr. Gayer did not enter an appearance.

28 <sup>18</sup> Exh. SWG-10.

<sup>19</sup> Exh. SWG-31.

<sup>20</sup> Exh. S-11.

<sup>21</sup> Exhs. S-12 and S-13.

<sup>22</sup> Exh. S-15.

<sup>23</sup> Exh. S-18.

<sup>24</sup> The hearing concluded on July 10, 2020.

1 public comment session.<sup>25</sup>

2 On July 13, 2020, a Procedural Order was issued establishing various post-hearing filing  
3 deadlines.

4 On July 24, 2020, Arizona Grain and RUCO jointly filed a brief in support of the motion to  
5 compel SWG to provide an updated rate case Schedule D to reflect the Company's current capital  
6 structure.

7 Also on July 24, 2020, SWG filed a brief in opposition to the motion to compel.

8 On July 31, 2020, Arizona Grain, RUCO, and SWG filed their respective reply briefs regarding  
9 the motion to compel.

10 On August 7, 2020, by Procedural Order, Arizona Grain and RUCO's joint motion to compel  
11 was granted, and SWG was directed to file an updated rate case Schedule D no later than August 12,  
12 2020.

13 On August 12, 2020, SWG filed an updated version of rate case Schedule D.

14 On August 26, 2020, SWG filed a Certification of Mailing and Publication, certifying that  
15 notice of the September 21, 2020, telephonic public comment session was mailed to its customers of  
16 record between July 15, 2020, and August 15, 2020, and posted in a prominent location of SWG's  
17 website on or before July 10, 2020.

18 On August 31, 2020, SWG, Arizona Grain, RUCO, and Staff filed their respective Closing  
19 Briefs. In addition, SWG,<sup>26</sup> RUCO,<sup>27</sup> and Staff filed their respective Final Schedules.

20 On September 9, 2020, RUCO filed its Final Schedules pertaining to cost of capital.<sup>28</sup>

21 On September 14, 2020, SWG, Arizona Grain, RUCO, and Staff filed their respective Reply  
22 Briefs.

23 On September 21, 2020, the telephonic public comment session was held as scheduled, with  
24

25 \_\_\_\_\_  
26 <sup>25</sup> The additional public comment session was scheduled because customer notice of the June 30, 2020, hearing date did  
not contain the correct call-in information for customers to provide public comment.

27 <sup>26</sup> SWG's closing brief and final schedules were filed after the Commission's regular business hours, and were therefore  
not docketed until September 1, 2020. No party objected to the timeliness of SWG's filings with the Commission.

28 <sup>27</sup> RUCO represented that the filing of its final schedules pertaining to cost of capital would be delayed due to the  
hospitalization of its cost of capital witness.

<sup>28</sup> No party objected to the timeliness of RUCO's filing with the Commission.

1 Commissioner Kennedy attending telephonically.<sup>29</sup> Seven members of the public appeared  
2 telephonically to provide statements in opposition to the Company's amended application.

3 On September 30, 2020, Commissioner Kennedy filed a letter in the docket requesting that  
4 additional public comment sessions be held during different times of the week to allow more robust  
5 participation from SWG ratepayers. Commissioner Kennedy further requested that the issue of further  
6 public comment sessions be placed on a Commission Open Meeting agenda for further discussion  
7 amongst the Commissioners.

8 On October 13, 2020, at the Commission's scheduled Open Meeting, the Commission discussed  
9 and considered Commissioner Kennedy's request that additional public comment sessions be convened  
10 to allow further participation from SWG ratepayers. At that time, the Commission directed the Hearing  
11 Division to convene two additional public comment sessions.

12 On October 14, 2020, a Procedural Order was issued scheduling two additional telephonic  
13 public comment sessions to convene on November 9, 2020, at 6:00 p.m., and on November 14, 2020  
14 (a Saturday), at 10:00 a.m.

15 On November 9, 2020, the telephonic public comment session was held as scheduled, with  
16 Commissioner Kennedy attending telephonically.<sup>30</sup> Mayor Tom Brady of Bullhead City appeared  
17 telephonically to provide statements in opposition to the Company's amended application.

18 On November 14, 2020, the telephonic public comment session was held as scheduled, with  
19 Commissioner Kennedy attending telephonically.<sup>31</sup> Two members of the public appeared  
20 telephonically to provide statements in opposition to the Company's amended application.

## 21 **II. The Parties**

### 22 **A. SWG**

23 SWG is a Nevada corporation providing gas utility service to approximately 2 million  
24 customers in Arizona, California, and Nevada. Approximately 1.1 million, or 54 percent, of the  
25 Company's customers are located in Arizona, including portions of Cochise, Gila, Graham, Greenlee,  
26

27 <sup>29</sup> None of the parties entered appearances.

28 <sup>30</sup> SWG's appearance was noted for the record. There were no other appearances from the parties.

<sup>31</sup> SWG's appearance was noted for the record. There were no other appearances from the parties.



1 La Paz, Maricopa, Pima, Pinal, and Yuma counties. SWG's current rates were established in Decision  
2 No. 76069 (April 11, 2017).

3 SWG is a subsidiary of Southwest Gas Holdings, Inc. ("SWG Parent").<sup>32</sup> SWG Parent owns  
4 business interests in two major utility industry segments: SWG and Centuri Construction Group, Inc.  
5 ("Centuri"). Centuri is a full-service contractor that works with local distribution utilities to install,  
6 construct, and maintain utility infrastructure throughout the United States and Canada.<sup>33</sup> Centuri is the  
7 parent company of NPL Construction Co. ("NPL"). NPL is an unregulated affiliate of SWG, and  
8 performs gas pipeline construction work for SWG in Arizona.<sup>34</sup>

9 **B. Mr. Gayer<sup>35</sup>**

10 Mr. Gayer is a residential customer of SWG and intervened on behalf of himself. Mr. Gayer  
11 was a passive participant in this matter, and did not take a formal position or otherwise participate in  
12 the hearing.

13 **C. Arizona Grain<sup>36</sup>**

14 Arizona Grain is a commercial customer of SWG. Arizona Grain supplies durum wheat to  
15 national and international markets, and sells grain seeds, including durum, alfalfa, corn, and barley.  
16 Arizona Grain has four locations in Arizona, one in California, and one in Colorado. Arizona Grain  
17 fully participated in the hearing and its positions and recommendations are set forth below.

18 **D. NatureSweet<sup>37</sup>**

19 NatureSweet is a commercial customer of SWG. NatureSweet USA operates a large  
20 greenhouse facility in Wilcox, Arizona, to grow tomatoes. NatureSweet USA utilizes natural gas from  
21 SWG to fuel its greenhouse boilers. NatureSweet USA was a passive participant in this matter, and  
22 did not take a formal position or otherwise participate in the hearing.  
23

24 <sup>32</sup> SWG Parent is incorporated in Delaware.

25 <sup>33</sup> SWG reports that during 2019, Centuri and its subsidiary companies served over 100 customers in North America,  
26 including: SWG; AEP; Avista; BGE; Columbia Gas; Dominion Energy; Duke Energy; Enbridge; Entergy; Minnesota  
27 Energy Resources; National Grid; Nicor Gas; ONE Gas; Peoples Gas; Southern California Gas Company; Union Gas;  
28 Washington Gas; and We Energies. Exh. SWG-40 at 12.

<sup>34</sup> See Section IV.B.5, *infra*, for a further discussion regarding the relationship between these entities.

<sup>35</sup> Mr. Gayer was granted intervention by Procedural Order dated July 17, 2019.

<sup>36</sup> Arizona Grain was granted intervention by Procedural Order dated August 29, 2019.

<sup>37</sup> NatureSweet was granted intervention by Procedural Order dated September 17, 2019.

**E. Bullhead City<sup>38</sup>**

Bullhead City is located in Mohave County, Arizona, and is a municipal customer of SWG. Bullhead City was a passive participant in this matter, and did not take a formal position or otherwise participate in the hearing.

**F. RUCO<sup>39</sup>**

RUCO was created by the Arizona Legislature in A.R.S. § 40-462 to represent the interests of residential utility consumers in Commission regulatory proceedings involving public service corporations.<sup>40</sup> RUCO fully participated in the hearing and its positions and recommendations are set forth below.

**G. Staff**

The Commission's Utilities Division is comprised of public utility financial analysts, engineers, and consultants, and is responsible for reviewing, among other things, all rate case filings with the Commission, and providing independent policy and rate recommendations to the Commission. Staff fully participated in the hearing and its positions and recommendations are set forth below.

**III. Summary of the Parties' Final Revenue Requirement Positions**

Through the multiple rounds of prefiled testimony and over the course of the hearing, the parties updated their initial positions on fair value rate base ("FVRB"), operating income, fair value rate of return ("FVROR"), and overall revenue requirement. Following the conclusion of the hearing, SWG, RUCO, and Staff filed final rate case schedules documenting their final positions, as set forth below.<sup>41</sup>

**SWG**

SWG is proposing total operating revenue of \$598,988,433, an increase of \$80,770,070 (or 15.59 percent), over adjusted TY revenue of \$518,218,363, to provide an operating income of \$160,342,564, and a 5.97 percent FVROR<sup>42</sup> on a proposed FVRB of \$2,687,107,697. SWG proposed rates that would increase the monthly bill for the typical single-family residential customer with

<sup>38</sup> Bullhead City was granted intervention by Procedural Order dated February 21, 2020.

<sup>39</sup> RUCO was granted intervention by Procedural Order dated July 3, 2019.

<sup>40</sup> A.R.S. § 40-462(A).

<sup>41</sup> Arizona Grain proposed various adjustments affecting the Company's revenue requirement, but did not submit formal rate case schedules.

<sup>42</sup> SWG's position on FVROR includes a 0.66 percent cost rate for Fair Value Increment. Exh. SWG-8 at 43.

average annual usage of 24 therms from \$36.16 to \$42.39, for an increase of \$6.23 (or 17.23 percent).

## RUCO

RUCO is proposing total operating revenue of \$552,561,928, an increase of \$34,343,564 (or 6.63 percent), over adjusted TY revenue of \$518,218,363, to provide an operating income of \$129,713,903, and a 5.10 percent FVROR<sup>43</sup> on a proposed FVRB of \$2,544,313,268. RUCO proposed rates that would increase the monthly bill for the typical single-family residential customer with average annual usage from \$36.16 to \$39.51, for an increase of \$3.35 (or 9.26 percent).

## Staff

Staff is recommending total operating revenue of \$572,453,650, an increase of \$54,235,287 (or 10.47 percent), over adjusted TY revenue of \$518,218,363, to provide an operating income of \$146,411,989, and a 5.47 percent FVROR<sup>44</sup> on a proposed FVRB of \$2,675,083,413. Staff recommended rates that would increase the monthly bill for the typical single-family residential customer with average annual usage from \$36.16 to \$40.90, for an increase of \$4.74 (or 13.11 percent).

## **IV. Rate Base**

### **A. Rate Base Summary**

SWG proposed an adjusted jurisdictional original cost rate base ("OCRB") of \$2,065,822,509; a reconstruction cost new depreciated rate base ("RCND") of \$3,308,392,886; and an overall FVRB of \$2,687,107,697. RUCO proposed an adjusted jurisdictional OCRB of \$1,964,371,171; an adjusted jurisdictional RCND of \$3,124,255,365; and an overall FVRB of \$2,544,313,268. Staff proposed an adjusted jurisdictional OCRB of \$2,053,798,224; an adjusted jurisdictional RCND of \$3,296,368,602; and an overall FVRB of \$2,675,083,413. Arizona Grain proposed several adjustments to rate base, but did not formally recommend a FVRB or otherwise provide schedules relating to rate base.

<sup>43</sup> See Section VI.D., *infra*. RUCO's position on FVROR assumes a 0.00 percent cost rate for Fair Value Increment. In the event that the Commission authorizes a return on the Fair Value Increment, RUCO recommended a cost rate of 0.18 percent.

<sup>44</sup> See Section VI.D., *infra*. Staff's position on FVROR assumes 0.00 percent cost rate for Fair Value Increment. In the event that the Commission authorizes a return on the Fair Value Increment, Staff recommended a cost rate of 0.30 percent for Fair Value Increment.

**B. Rate Base Adjustments**

**1. Post-Test Year Plant**

In its amended application, SWG proposed an adjustment to rate base to include approximately \$230 million in certain non-revenue producing, used and useful PTYP additions that were placed in service during the 11-month period beginning February 1, 2019 through December 31, 2019 (the “PTYP Period”).

We note that the Commission is currently in the process of reviewing its policy on PTYP.<sup>45</sup> As a result, our treatment of PTYP herein is confined strictly to the unique facts and circumstances of this case, and should therefore not be instructive of any new general policy directive by the Commission.

**a. PTYP Period**

SWG

SWG argues that the 11-month PTYP Period is consistent with similar PTYP adjustments approved by the Commission in recent cases. According to the Company, the PTYP adjustment in this case is reasonable and in the public interest because the adjustment is limited to non-revenue producing plant placed into service following the end of the test year, and the adjustment otherwise satisfies ratemaking and accounting principles, namely the matching principle. Additionally, the Company asserts that the PTYP adjustment period is appropriate because it mitigates regulatory lag.<sup>46</sup>

In response to Arizona Grain’s position that a 3 to 6-month limitation on PTYP is appropriate, SWG submits that the Commission has more frequently approved a 12-month PTYP period than any other adjustment period since 2014.<sup>47</sup> Further, SWG contends that its proposed 11-month PTYP adjustment period is appropriate because it will more accurately align the Company’s proposed cost of service with the level of costs that the Company will incur to serve its customers.<sup>48</sup>

Arizona Grain

Arizona Grain generally asserts that the Company’s “explosive rate base growth is unprecedented, unexplained, and *per se* imprudent.”<sup>49</sup> According to Arizona Grain, the Company’s

<sup>45</sup> In the Matter of a Docket Evaluating Commission Policy on Post-Test Year Plant, Docket No. AU-00000A-19-0080.

<sup>46</sup> SWG Closing Brief (“Cl. Br.”) at 5.

<sup>47</sup> Tr. Vol II at 1303:7-24.

<sup>48</sup> SWG Cl. Br. at 5-6.

<sup>49</sup> Arizona Grain (“AG”) Reply Brief (“Reply Br.”) at 1.

1 “rate base explosion [was] the direct result of [SWG’s] VSP and COYL programs.”<sup>50</sup> As support,  
 2 Arizona Grain submits that SWG’s proposed original cost rate base (“OCRB”) has increased by \$741  
 3 million (or 56.0 percent), from \$1.325 billion in the Company’s last rate case,<sup>51</sup> to \$2.066 billion in this  
 4 proceeding. Further, Arizona Grain submits that SWG’s requested PTYP in this proceeding is 557.6  
 5 percent higher than the PTYP amount requested in the Company’s last rate case.<sup>52</sup> Stated another way,  
 6 Arizona Grain maintains that the PTYP requested by SWG in its last rate case was 3.7 percent of  
 7 OCRB, while the PTYP proposed by SWG in this proceeding is 19.9 percent of the Company’s  
 8 proposed OCRB.<sup>53</sup>

9 Arizona Grain contends that there are a number of factors that weigh against the inclusion of  
 10 PTYP in this case, including the high amount of PTYP relative to the Company’s overall capitalization;  
 11 the lack of evidence showing a detriment to the Company’s financial health resulting from disallowing  
 12 PTYP; the lack of evidence showing that the PTYP was required for public safety; and the lack of  
 13 evidence showing that the PTYP is revenue neutral.<sup>54</sup> Although Arizona Grain states that “the  
 14 Commission would be fully justified in rejecting all of the [PTYP] in [SWG’s] amended application,”  
 15 Arizona Grain submits two options for the Commission’s consideration: 1) limit the inclusion of PTYP  
 16 in this case to the 3.7 percent of PTYP to overall capitalization allowed in the Company’s last rate case;  
 17 or 2) limit the PTYP adjustment period to between three and six months.<sup>55</sup> Arizona Grain claims that  
 18 either option “would be fair to customers and the Company.”<sup>56</sup>

#### 19 RUCO

20 RUCO did not object to the proposed PTYP Period, but rather expressed concern regarding “the  
 21 expectation of recovery and the unlimited amount of PTYP,” as well as the “excessive” amount of  
 22 proposed PTYP compared to SWG’s last rate case.<sup>57</sup>

24 <sup>50</sup> AG Cl. Br. at 8.

25 <sup>51</sup> See Decision No. 76069 (April 11, 2017).

26 <sup>52</sup> Specifically, Arizona Grain notes that the Company is requesting to include PTYP in the amount of \$263.5 million in  
 this proceeding, compared with \$40.1 million in PTYP in the Company’s last rate case. AG Cl. Br. at 16-17.

27 <sup>53</sup> AG Cl. Br. at 16-17.

28 <sup>54</sup> *Id.* at 16.

<sup>55</sup> *Id.* at 18.

<sup>56</sup> *Id.*

<sup>57</sup> RUCO Reply Br. at 3.



1        Staff

2        Staff is in agreement with the Company's proposed PTYP Period.<sup>58</sup>

3        Resolution

4        We do not find that the 11-month PTYP adjustment period proposed by the Company is  
5 reasonable and appropriate under the circumstances. In line with Arizona Grain's recommendation,  
6 we find that a 6-month PTYP Period is more appropriate in this case because of the excessive amount  
7 of proposed PTYP.

8                    **b.        PTYP Accumulated Depreciation Adjustment**

9        SWG

10        SWG asserts that its proposed PTYP does not include an adjustment to accumulated  
11 depreciation because the Company treats its PTYP as being added to rate base at the end of the last  
12 month of the TY. According to SWG, since there is no accumulated depreciation recorded on the  
13 Company's books for that plant, no adjustment for accumulated depreciation to PTYP is warranted in  
14 this case. SWG maintains that the Commission has accepted this methodology in prior cases, and that  
15 methodology should therefore be adopted in this case.<sup>59</sup>

16        SWG opposes Staff's recommendation that the Company's PTYP be treated for regulatory  
17 accounting purposes as being placed in service midway through the year to adjust depreciation expense  
18 on PTYP by one-half. SWG maintains that Staff's recommendation will result in more accumulated  
19 depreciation in rate base for PTYP than for plant added in the last few months of the test year. As a  
20 result, SWG contends that Staff's recommendation violates the matching principle and should be  
21 rejected.<sup>60</sup>

22        In response to RUCO's proposal to adjust PTYP to include all accumulated depreciation during  
23 the PTYP Period, SWG generally argues that RUCO's adjustments regarding PTYP contradict the  
24 manner in which the Commission has historically treated PTYP, as well as the underlying policy  
25 rationale behind allowing the PTYP adjustment, namely to reduce regulatory lag. SWG maintains that  
26

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27        <sup>58</sup> Staff Cl. Br. at 5.

28        <sup>59</sup> SWG Cl. Br. at 7.

<sup>60</sup> *Id.*

the Company's proposal will mitigate, but not eliminate, regulatory lag because the PTYP included in the Company's proposal will potentially be one year or more removed from the PTYP Period by the time new rates go into effect. According to SWG, the Company will not recover any depreciation expense on its PTYP until new rates take effect. SWG asserts that its PTYP adjustment balances the interest of customers and shareholders and results in just and reasonable rates that more closely reflect the Company's cost of service.<sup>61</sup>

Further, SWG states that RUCO's proposal to "roll forward" the accumulated depreciation on TY plant to the PTYP Period "distorts the historical test year and will result in rates that under-recover the Company's cost of service when rates from this proceeding go into effect, thereby exacerbating regulatory lag." SWG also contends that the "roll forward" proposal would include accumulated depreciation for a significant level of plant for which the Company is not yet recovering depreciation expense from customers. As a result, SWG argues that RUCO's "roll forward" proposal should be disregarded as inequitable; contradictory to ratemaking and accounting principles surrounding PTYP adjustments; and is unnecessary.<sup>62</sup>

#### Arizona Grain

Arizona Grain states that it supports RUCO's position that any PTYP should be offset by accumulated depreciation.<sup>63</sup>

#### RUCO

RUCO contends that the amount of PTYP proposed by the Company and Staff is excessive. RUCO notes that the amount of PTYP proposed in this case (\$228,074,561) is 557.60 percent higher than the PTYP proposed by the Company in its last rate case (\$40,071,749). RUCO submits that over the last 10 years, there has become an "expectation" that all requested PTYP will be recovered without regard to whether the PTYP relates to the test year or the existence of unusual or special circumstances.<sup>64</sup> According to RUCO, "[i]t is only fair that if the Commission is being asked to include a very generous PTYP allowance that the Commission consider: 1) rolling the test year [accumulated

<sup>61</sup> SWG Cl. Br. at 8-9.

<sup>62</sup> *Id.* at 8.

<sup>63</sup> AG Cl. Br. at 19.

<sup>64</sup> RUCO Cl. Br. at 10.

1 depreciation] forward to the same time period; and 2) including the [accumulated depreciation] on the  
2 PTYP.”<sup>65</sup> RUCO’s proposed adjustments would reduce the Company’s rate base by approximately  
3 \$45 million.<sup>66</sup>

4 RUCO argues that its proposed adjustments to accumulated depreciation are based on equity  
5 and fairness considerations. According to RUCO, the proposals will benefit both the Company and  
6 ratepayers by reducing regulatory lag while allowing ratepayers to receive the benefit of the plant that  
7 they paid for in the PTY period through a reduction in rates.<sup>67</sup>

8 In response to SWG’s assertions that RUCO’s proposals violate the matching principle and the  
9 historic test year, RUCO notes that allowing PTYP in the first instance is a departure from both normal  
10 accounting and regulatory concepts. RUCO maintains that the accumulated depreciation that it  
11 proposes to “roll forward” necessarily matches the historic test year because that amount is the test year  
12 accumulated depreciation balance. According to RUCO, the Commission should only allow the  
13 inclusion of PTYP in this case with appropriate limits that offset the impact to ratepayers. RUCO  
14 argues that allowing the Company’s proposed PTYP without adjusting for accumulated depreciation  
15 would result in rates that are unfair and unreasonable.<sup>68</sup>

16 Staff

17 Staff asserts that SWG’s position on accumulated depreciation violates the matching principle  
18 by including annualized depreciation on PTYP without making any corresponding adjustment to  
19 accumulated depreciation. According to Staff, the typical accounting for depreciation expense and  
20 accumulated depreciation under the Uniform System of Accounts (“USOA”) involves debiting  
21 depreciation expense for the accrued depreciation and crediting the accumulated depreciation account  
22 by the same amount. Staff contends that failure to make any adjustment to accumulated depreciation  
23 for the increased depreciation expense results in an overstatement of rate base. Therefore, Staff  
24 adjusted rate base by one-half of the depreciation expense on PTYP in order to recognize the average  
25 impact on rate base for the post-test year period.<sup>69</sup> Staff’s proposed adjustment would reduce rate base

26 <sup>65</sup> *Id.* at 11.

27 <sup>66</sup> Exh. RUCO-20, Schedule JMM-5.

28 <sup>67</sup> RUCO Reply Br. at 3-4.

<sup>68</sup> *Id.* at 2-3.

<sup>69</sup> Staff Cl. Br. at 8-9.

1 by approximately \$633,000.<sup>70</sup>

2 In response to SWG's assertion that Staff's proposed accumulated adjustment violates the  
3 matching principle, Staff argues that the Company has in fact violated the matching principle by failing  
4 to make any adjustment to accumulated depreciation to account for the increased depreciation expense  
5 on PTYP. Staff submits that adjustments to accumulated depreciation related to increased depreciation  
6 expense on PTYP have been made in various ways in utility rate cases based on the specific facts and  
7 circumstances of each case. Staff states that "[v]ariations on the application of the matching concept,  
8 as applied to depreciation expense on PTYP include: 1) no matching (advocated by Southwest Gas in  
9 the current case); 2) full matching (used by APS in its rate case, where accumulated depreciation is  
10 extended through the same period as PTYP); and 3) reflecting one-half of the increased depreciation  
11 expense on PTYP as the ratemaking adjustment to accumulated depreciation, i.e., partial matching,  
12 which is the approach used by Staff in the current Southwest Gas rate case."<sup>71</sup> Staff contends that its  
13 proposal is a reasonable application of the matching principle and should be applied for the purpose of  
14 this proceeding.<sup>72</sup>

15 Resolution

16 We are unpersuaded that any of the proposals submitted by the parties with respect to  
17 accumulated depreciation on PTYP violate the matching principle. As noted by Staff, various  
18 approaches to treat accumulated depreciation on PTYP have been employed by the utility industry,  
19 none of which necessarily violate the matching principle. Specifically, we note that SWG will begin  
20 recording depreciation expense and accumulated depreciation on the PTYP at the time that plant is  
21 placed in service. Since SWG will begin recording depreciation expense and accumulated depreciation  
22 at the same time and at the same amount, we find that the matching principle will not be violated.

23 The purpose of including PTYP in rate base is to reduce regulatory lag. Given that the  
24 Company's PTYP will be placed into service prior to the time that rates that include that PTYP,  
25 regulatory lag has already occurred. We note that typical regulatory lag has been exacerbated in this  
26 case due to delays caused by the COVID-19 global pandemic. As a result, a period of more than one

27 <sup>70</sup> Exh. S-4 at 7.

28 <sup>71</sup> Staff Reply Br. at 3.

<sup>72</sup> *Id.* at 3-4.

1 year will have passed since the time that the PTYP was placed in service and the implementation of  
2 new rates. Under the specific circumstances of this case, we find that including PTYP in rate base  
3 without an adjustment for accumulated depreciation will assist in allowing SWG to recover its costs  
4 by mitigating regulatory lag which, in turn, will contribute to just and reasonable rates.

5 **c. PTYP Retirement Adjustment**

6 SWG

7 SWG asserts that its proposed PTYP does not include an adjustment for PTYP retirements  
8 because the Company treats its PTYP as being added to rate base at the end of the last month of the  
9 TY. SWG maintains that since “it is unlikely that any related retirements are recorded” on the  
10 Company’s books at the end of the TY, no adjustment for PTYP retirements is warranted in this case.  
11 According to SWG, the Commission has accepted this methodology in prior cases.<sup>73</sup>

12 In response to RUCO, SWG argues that RUCO’s position incorrectly posits that the Company  
13 is requesting a return on its retirements. Rather, SWG contends that retirements do not have a material  
14 impact on revenue requirement because the actual retirement and the cost of removal have offsetting  
15 impacts to the revenue requirement. Although the retirement of plant reduces depreciation expense,  
16 SWG states that such retirement has no impact on rate base because “the cost of removal decreases  
17 accumulated depreciation, which increases rate base, but has no impact on depreciation expense.”<sup>74</sup>

18 Arizona Grain

19 Arizona Grain states that it supports RUCO’s position that PTYP retirements should be  
20 removed from rate base.<sup>75</sup>

21 RUCO

22 RUCO argues that PTYP should be adjusted to remove retired PTYP because the failure to  
23 remove that plant would unjustly enrich SWG through the continued collection of depreciation expense  
24 in the amount of the plant that was retired. According to RUCO, “the retired post-test year plant is no  
25 longer in use, it is not known and measurable, and ratepayers should not have to wait until the  
26

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27 <sup>73</sup> SWG Cl. Br. at 7.

28 <sup>74</sup> *Id.* at 9.

<sup>75</sup> AG Cl. Br. at 19.



1 Company's next rate case to get credit for its removal." RUCO submits that the amount of PTYP  
2 retirements at issue, as depicted in the Company's depreciation rates, amounts to approximately \$43.5  
3 million.<sup>76</sup>

4 Staff

5 Staff did not present argument relating to this proposed adjustment.

6 Resolution

7 We find that an adjustment is appropriate to recognize the retirement of plant replaced by PTYP.  
8 We agree with RUCO that such an adjustment is necessary in order to avoid double-recovery of plant  
9 through depreciation expense. In this regard, we note that absent such an adjustment, the accounting  
10 journal entry to retire the replaced plant would result in a permanent decrease to accumulated  
11 depreciation. The decrease to accumulated depreciation would provide an unwarranted economic  
12 benefit to the Company equivalent to the depreciation expense on the retired plant that would otherwise  
13 be included in rates absent the adjustment for retired plant. Accordingly, we adopt RUCO's proposed  
14 adjustment for PTYP retirements.

15 **d. Durango Building Adjustment**

16 In its amended application, the Company seeks to include approximately \$4.5 million in  
17 jurisdictional costs associated with Company's office building located on Durango Road in Las Vegas,  
18 Nevada ("Durango Building"). The Durango Building is currently under construction; the Company  
19 therefore only seeks to include the jurisdictional costs associated with 55 percent<sup>77</sup> of the building and  
20 the associated land as PTYP.<sup>78</sup>

21 SWG

22 The Company's existing headquarters is located on Spring Mountain Drive in Las Vegas,  
23 Nevada. The Durango Building consists of two floors, one of which is vacant and currently under  
24 construction, and the other is currently dedicated to housing SWG employees and contractors working  
25

26  
27 <sup>76</sup> RUCO Cl. Br. at 12-13.

28 <sup>77</sup> The 55 percent allocation represents the proportional square footage of the first floor of the building. The second floor of the building is currently under construction and is not in use. Exh. SWG-24 at 20.

<sup>78</sup> Exh. SWG-24 at 20-21.

1 on the Customer Data Modernization Initiative (“CDMI”) project.<sup>79</sup> According to SWG, the Durango  
2 Building will be the Company’s new headquarters once construction is completed.<sup>80</sup>

3 In response to Staff, SWG asserts that the Company is not seeking duplicative recovery of two  
4 office buildings because the Durango Building is being utilized to complete its “very large, multi-year  
5 [CDMI project].”<sup>81</sup> SWG further asserts that, even though the CDMI is not yet operational, the  
6 Durango building is used and useful because it has been placed in service for the Company’s general  
7 business purposes.<sup>82</sup>

8 Arizona Grain

9 Arizona Grain did not present argument relating to this proposed adjustment.

10 RUCO

11 RUCO did not present argument relating to this proposed adjustment.

12 Staff

13 Staff recommends adjusting rate base to remove the jurisdictional costs associated with the  
14 Durango Building. According to Staff, the Durango Building remains in construction and is not used  
15 and useful in terms of providing service to its customers.<sup>83</sup>

16 Resolution

17 We note that SWG will not begin depreciating the Durango Building until construction is  
18 completed. We therefore find that including the Durango Building in rate base and recognizing  
19 depreciation expense thereon prior to its completion would provide a mismatch that is inequitable for  
20 ratepayers. Although, as with other plant, the Company will not be able to fully recover plant placed  
21 in service between rate cases in the absence of special treatment, the building remains under  
22 construction and it would be inappropriate to place only a portion of the Durango Building in rate base.  
23 Moreover, we agree with Staff that the Durango Building is not presently used and useful in the  
24

25 <sup>79</sup> The CDMI project involves updating and upgrading the Company’s legacy customer information systems. The Company  
26 has a pending application requesting an accounting order to defer the costs associated with the CDMI project. *See generally*  
27 Docket No. G-01551A-19-0064 (“In the Matter of the Application of Southwest Gas for an Accounting Order Authorizing  
28 the Deferral of Costs Related to Implementation of its Customer Data Modernization Initiative”).

<sup>80</sup> SWG Cl. Br. at 14-15; SWG Reply Br. at 8-9.

<sup>81</sup> SWG Cl. Br. at 14-15.

<sup>82</sup> SWG Reply Br. at 9.

<sup>83</sup> Staff Cl. Br. at 6.

1 provision of service to customers. To the extent that the Durango Building is being utilized to complete  
 2 the CDMI project, that issue is better addressed in the Company's pending accounting order docket  
 3 involving the CDMI project.<sup>84</sup> Accordingly, we adopt Staff's recommended adjustment with respect  
 4 to the Durango Building.

5 **e. Post-Test Year System Allocable Correction of Account 303 Error**  
 6 **Adjustment**

7 Staff discovered an error in the Company's post-test year System Allocable Plant Account 303  
 8 during its review of the Company's response to Staff Data Request No. 17-007.<sup>85</sup> SWG concurs with  
 9 Staff and agrees that its System Allocable Plant Account 303 should be reduced by approximately \$1.2  
 10 million.<sup>86</sup>

11 Although the Company agreed to Staff's adjustment, the Final Schedules submitted on behalf  
 12 of the Company do not reflect that adjustment. We therefore find that the adjustment is appropriate,  
 13 and hereby adjust the Company's proposed rate base accordingly.

14 **f. PTYP VSP Adjustment**

15 SWG seeks to include approximately \$100 million in plant costs associated with the VSP  
 16 program as part of its proposed PTYP. The VSP program was approved by the Commission in Decision  
 17 No. 76069 (April 11, 2017), and was intended to fund the Company's proactive replacement of pre-  
 18 1970's vintage pipeline<sup>87</sup> within the Company's Arizona service territory on an accelerated basis. The  
 19 purpose of the VSP program is to allow SWG the flexibility to proactively replace VSP before that  
 20 pipe became unsafe or regulations required their replacement over a short period of time.<sup>88</sup> To that  
 21 end, one of the goals of the VSP program is to provide a means for the Company to timely and gradually  
 22 adjust rates to account for the costs of those replacements.<sup>89</sup>

23 SWG

24 SWG opposes Arizona Grain's position that all PTYP investments associated with the VSP

25 <sup>84</sup> See Docket No. G-01551A-19-0064.

26 <sup>85</sup> Exh. S-4 at 5.

27 <sup>86</sup> Exh. SWG-25 at 4. No party objected to Staff's proposed adjustment.

28 <sup>87</sup> Pre-1970's main and service pipelines are generally unprotected steel that could develop higher leak rates than newer generations of pipe.

<sup>88</sup> Exh. SWG-36 at 17-18.

<sup>89</sup> Decision No. 76069 at 11.

1 program should be excluded from rate base. According to SWG, the plant associated with these  
2 programs should be included in rate base because they were constructed and placed in service pursuant  
3 to the Commission's currently authorized programs. Although Arizona Grain recommends that the  
4 Commission evaluate the ongoing nature and efficacy of these programs in a separate proceeding, SWG  
5 argues that there is no connection between the requested recovery for work already performed and  
6 whether these programs will continue on a going forward basis at the conclusion of this rate case  
7 proceeding. SWG submits that the VSP plant was constructed pursuant to the Commission-approved  
8 Plan of Administration ("POA"), and states that no party has presented evidence in this proceeding to  
9 suggest otherwise. SWG notes that pursuant to the VSP program POA, the Company reviewed all  
10 VSP-related projects with Staff prior to undertaking them and provided extensive detail in its annual  
11 filings with respect to the work performed. As a result, SWG asserts that the VSP PTYP additions  
12 were prudently incurred and should be included in rate base.<sup>90</sup>

13 Arizona Grain

14 Arizona Grain proposes an adjustment to the Company's rate base to remove the costs  
15 associated with the VSP program during the PTYP Period.<sup>91</sup> Arizona Grain argues that although the  
16 Commission authorized the VSP program in the Company's last rate case, the Commission did not  
17 guarantee permanent recovery of the resulting expenditures. Arizona Grain explains that only  
18 prudently incurred plant investments necessary to provide service should be included in a utility's rate  
19 base. According to Arizona Grain, the VSP program investments were not prudently incurred because  
20 the replaced pipeline was otherwise "perfectly functioning," and "the replacements were not required  
21 by public health or safety."<sup>92</sup> Further, Arizona Grain argues that SWG failed to provide evidence  
22 demonstrating that its VSP program investments were prudently incurred. As a result, Arizona Grain  
23 contends that the post-test year VSP program investments should not be included in rate base.<sup>93</sup>

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27 <sup>90</sup> SWG Cl. Br. at 10-11; SWG Reply Br. at 6-7.

28 <sup>91</sup> Arizona Grain states that it does not oppose inclusion of TY COYL plant in rate base. AG Reply Br. at 5.

<sup>92</sup> AG Cl. Br. at 9.

<sup>93</sup> *Id.*

RUCO

RUCO did not present argument relating to this proposed adjustment.<sup>94</sup>

Staff

Staff did not present argument relating to this proposed adjustment.

Resolution

We find that the PTYP additions associated with VSP program plant were prudently incurred pursuant to a Commission-approved program and POA, are used and useful in the provision of gas utility service to customers, and should therefore be included in rate base. In this regard, we note that Staff examined SWG's gas distribution system and equipment and concluded that, except as otherwise reflected in Staff's recommended adjustments, "all projects and equipment were found to be used and useful."<sup>95</sup> Moreover, there is no evidence suggesting that SWG failed to comply with the terms and conditions of the Commission-approved VSP program, including the POA. Accordingly, we decline to adopt Arizona Grain's adjustment to exclude VSP PTYP from rate base.

**g. PTYP Adjustment for Routine Plant**

RUCO proposed an adjustment to remove approximately \$32.5 million<sup>96</sup> from rate base from the following PTYP accounts:

- Account 391 – Office Furniture and Fixtures
- Account 391.1 – Computer Hardware and Software
- Account 392.11 – Vehicles
- Account 394 – Tools, Shop, and Garage Equipment
- Account 395 – Laboratory Equipment
- Account 397 – Communications Equipment
- Account 398 – Miscellaneous Equipment<sup>97</sup>

<sup>94</sup> We note, however, that RUCO stated in its Closing Brief that "RUCO does not question whether the PTYP is used and useful or whether it is prudent." RUCO Cl. Br. at 8.

<sup>95</sup> Exh. S-15 at 3.

<sup>96</sup> Exh. RUCO 19 at 8.

<sup>97</sup> *Id.* at 18. We note that although RUCO's Closing Briefs did not specifically provide argument supporting its proposed adjustment for routine PTYP, RUCO's Final Schedules incorporate that adjustment.



1        SWG

2        SWG argues that the plant items identified by RUCO should be included in rate base because  
3 they are used and useful and the costs were prudently incurred. In response to RUCO's argument that  
4 routine plant should be excluded from PTYP, SWG maintains that RUCO has not provided any  
5 Commission authority that limits PTYP to non-routine investments involving backbone infrastructure.  
6 SWG asserts that since there is no evidence suggesting that these plant items are not used and useful,  
7 and that the costs are otherwise unreasonable, RUCO's proposed adjustment to remove these plant  
8 items should be denied.<sup>98</sup>

9        Arizona Grain

10       Arizona Grain did not present argument relating to this proposed adjustment.

11       RUCO

12       RUCO argues these plant items should be removed from PTYP because they are not critical  
13 backbone plant for the distribution of gas service to customers in Arizona. According to RUCO, these  
14 plant items are routine in nature and should therefore be removed from PTYP.<sup>99</sup>

15       Staff

16       Staff did not present argument relating to this proposed adjustment.

17       Resolution

18       As discussed above, Staff examined SWG's gas distribution system and equipment and  
19 concluded that, except as otherwise reflected in Staff's recommended adjustments, "all projects and  
20 equipment were found to be used and useful."<sup>100</sup> Although RUCO suggests that these plant items  
21 should be excluded from PTYP because they constitute routine plant expenditures, RUCO has not  
22 presented argument or evidence to rebut the showing that these plant items are used and useful, and  
23 that the costs are otherwise reasonable. Accordingly, we decline to adopt RUCO's proposed  
24 adjustment to exclude the plant items referenced above.

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27       <sup>98</sup> SWG Reply Br. at 4-5.

28       <sup>99</sup> Exh. RUCO-19 at 18-19.

<sup>100</sup> Exh. S-15 at 3.

## 2. TY VSP Plant Adjustment

In addition to arguing that all PTYP associated with the VSP program be excluded from rate base, Arizona Grain further argues that all VSP plant invested after the Company's last rate case through the end of the TY should similarly be excluded from rate base. Arizona Grain submits that SWG expended approximately \$130 million in VSP plant over this time period.<sup>101</sup>

### Resolution

The parties' arguments for and against adjusting rate base to exclude PTYP associated with the VSP program are the same for excluding TY VSP plant.<sup>102</sup> For the reasons discussed above, we find that the VSP program plant additions from the Company's last rate case through the end of the TY in this case were prudently incurred, are used and useful in the provision of gas utility service to customers, and should therefore be included in rate base. Accordingly, we decline to adopt Arizona Grain's rate base adjustment to remove VSP plant installed after the Company's last rate case through the end of the TY.

## 3. Private Corporate Aircraft Adjustment

### SWG

SWG seeks to include in rate base approximately \$2 million in jurisdictional costs associated with the Company's private corporate aircraft, hangar, and equipment. According to SWG, the costs are reasonable, and the private aircraft is used and useful because the Company utilizes the aircraft to facilitate travel for the Company's executives and other personnel to Arizona from the Company's headquarters in Las Vegas, Nevada.<sup>103</sup>

### Arizona Grain

Arizona Grain states that it supports RUCO's recommendation to remove the costs associated with the Company's ownership of corporate aircraft, hangar, and associated equipment. According to Arizona Grain, there is no reason why customers should pay for the convenience of SWG's executives to fly private and avoid flying commercial.<sup>104</sup>

<sup>101</sup> AG Cl. Br. at 11.

<sup>102</sup> See Section IV.B.1.f., *supra*. We note that Staff and RUCO took no position with respect to Arizona Grain's proposed adjustment.

<sup>103</sup> SWG Cl. Br. at 22-23.

<sup>104</sup> AG Cl. Br. at 22-23.

1        RUCO

2        RUCO argues that the costs associated with the Company-owned aircraft, hangar, and  
3 associated equipment be removed from rate base. According to RUCO, none of these costs are  
4 necessary for the provision of natural gas services in Arizona.<sup>105</sup>

5        Staff

6        Staff recommends adjusting the Company's proposed rate base to remove the jurisdictional  
7 costs associated with the corporate aircraft. Staff indicates that the Company has not met its burden of  
8 proving that ownership of this asset is used and useful because the Company has failed to identify the  
9 frequency of use and the extent to which it serves to offset the cost of commercial travel.<sup>106</sup>

10       Resolution

11       We do not believe that ratepayers should pay for the costs associated with the Company's  
12 ownership, use, and maintenance of a private corporate aircraft used nearly exclusively for executive  
13 travel. To the extent that SWG believes that convenience and/or necessity requires the ownership and  
14 maintenance of a private aircraft to facilitate executive air travel to and from Arizona, we believe that  
15 SWG shareholders should be responsible for the entirety of those costs absent evidence of cost savings  
16 over commercial travel. Further, against the backdrop and lessons learned from the ongoing global  
17 COVID-19 pandemic, we anticipate and expect that SWG will rely more frequently on  
18 video/teleconferencing platforms as a means of communication, rather than traveling for in-person  
19 meetings. Accordingly, we find that the proposed adjustment to remove the jurisdictional costs  
20 associated with the private corporate aircraft is reasonable under the circumstances, and should  
21 therefore be adopted.

22                    **4. Directors and Officers Liability Insurance (Prepaid) Adjustment**

23        Directors and Officers ("D&O") liability insurance covers the board of directors and officers  
24 against lawsuits alleging any breach of fiduciary duty. D&O insurance generally covers situations  
25 where a shareholder sues the directors or officers of an investor-owned corporation.<sup>107</sup>

27        <sup>105</sup> RUCO Cl. Br. at 13.

28        <sup>106</sup> Staff Cl. Br. at 7.

<sup>107</sup> Exh. SWG-26 at 6.

1        SWG

2        SWG proposed to include in rate base approximately \$225,000 in jurisdictional costs associated  
3 with prepaid D&O liability insurance expense. SWG notes that no party to this proceeding challenges  
4 the level of D&O coverage or the associated expense, and states that both Staff and RUCO  
5 acknowledge that D&O is a necessary insurance.<sup>108</sup> According to the Company, reasonably and  
6 prudently incurred costs, incurred in the provision of providing utility service, are fully recoverable.

7        Arizona Grain

8        Arizona Grain did not present argument relating to this proposed adjustment.

9        RUCO

10       RUCO recommends reducing the jurisdictional amount of prepaid D&O insurance by 50  
11 percent. According to RUCO, costs associated with D&O insurance should be shared between  
12 shareholders and ratepayers because both benefit equally from that insurance.<sup>109</sup>

13       Staff

14       Staff also recommends reducing the jurisdictional amount of prepaid D&O insurance by 50  
15 percent. Specifically, Staff contends that the prepaid cost of D&O insurance should be split evenly  
16 between ratepayers and shareholders because both benefit from that insurance. Staff maintains that  
17 shareholders benefit from D&O insurance because the policy generally covers the costs associated with  
18 a lawsuit, which are costs not recoverable from ratepayers. Further, Staff states that ratepayers benefit  
19 from D&O insurance because that policy improves the ability of a corporation to attract and retain  
20 qualified directors and officers.<sup>110</sup>

21       Resolution

22       We agree with Staff and RUCO that D&O liability insurance benefits both ratepayers and  
23 shareholders. We therefore find that the costs associated with D&O liability insurance should be split  
24 evenly between both ratepayers and shareholders. Accordingly, we adopt the recommendations of  
25 Staff and RUCO to reduce rate base by \$112,500 to reflect a 50 percent reduction to the Company's  
26 proposed jurisdictional amount of prepaid D&O liability insurance.

27       <sup>108</sup> SWG Cl. Br. at 16; SWG Reply Br. at 9-10.

28       <sup>109</sup> RUCO Cl. Br. at 23.

<sup>110</sup> Staff Cl. Br. at 9-10.

## 5. Affiliate Profits Adjustment

Arizona Grain proposed an adjustment to rate base to remove approximately \$24.1 million in estimated profit earned by SWG's affiliate, NPL, through its contractual pipeline installation work for SWG. In addition, Arizona Grain recommends that the Commission require the oversight of an independent monitor for all future awards of construction contracts.<sup>111</sup>

### SWG

SWG disputes Arizona Grain's rate base adjustment to account for work performed by NPL for several reasons. First, SWG contends that Arizona Grain has not provided any substantive evidence to support its assertion that NPL's profits inappropriately increased the Company's cost of service. According to SWG, the evidence shows that the Company has an unbiased and prudent process for soliciting multiple bids from various qualified contractors and awarding gas pipeline construction work based on the lowest bid. SWG submits that when gas pipeline work was awarded to NPL, that award was extended because NPL was the lowest and most competitive bidder, which benefits customers. Further, SWG submits that no party presented any evidence indicating that NPL is not a duly qualified pipeline construction contractor for the Company.<sup>112</sup>

In addition, SWG claims that Arizona Grain's affiliate adjustment amounting to \$21.2 million "is a fictitious amount" and utilizes "a highly flawed calculation based on speculative assumptions and manipulation of financial figures."<sup>113</sup> According to SWG, the Company's use of NPL, as well as the costs incurred for the work performed, are prudent, in the public interest, and should be recoverable by SWG. Therefore, SWG maintains that the Commission should reject Arizona Grain's proposed adjustment.<sup>114</sup>

### Arizona Grain

Arizona Grain submits that from the end of the TY used in the Company's last rate case (December 1, 2015) through the end of the TY in this proceeding (January 31, 2019), SWG paid NPL approximately \$246.7 million for work on gas pipeline installation projects in Arizona.<sup>115</sup>

<sup>111</sup> AG Cl. Br. at 22.

<sup>112</sup> SWG Reply Br. at 7-8.

<sup>113</sup> SWG Cl. Br. at 13.

<sup>114</sup> SWG Reply Br. at 8.

<sup>115</sup> AG Cl. Br. at 21; Exh. AG-3 at 8.



1 Arizona Grain maintains that a utility's transactions with an unregulated affiliate require strict  
 2 scrutiny, and the Commission should carefully review the transactions to ensure that the utility is not  
 3 paying more than it would if it performed the work itself. In this case, Arizona Grain states that "the  
 4 potential for abuse is real and substantial" given the magnitude of the Company's affiliated construction  
 5 projects with NPL.<sup>116</sup> As a result, Arizona Grain recommends that the Commission require the  
 6 oversight of an independent monitor for all awards of construction contracts in Arizona.<sup>117</sup>

7 Arizona Grain argues that the pipeline installation projects awarded to NPL are problematic  
 8 "because essentially all of [the] work [was] capitalized and included in rate base, [and] customers are  
 9 being asked to pay two layers of profit on [those capital] expenditures."<sup>118</sup> According to Arizona Grain,  
 10 the profits earned by NPL are capitalized in rate base, which SWG in turn earns a rate of return on.

11 Arizona Grain estimated the profit margin for NPL since SWG's last rate case by extrapolating  
 12 the ROE for Centuri, which was reported in SWG Parent's annual utility report for 2018. Based on its  
 13 analysis, Arizona Grain argues that Centuri's ROE since SWG's last rate case is conservatively  
 14 estimated at 9.4 percent. After applying an estimated 9.4 percent ROE on the \$246.7 million paid by  
 15 SWG to NPL, Arizona Grain submits that NPL earned an estimated \$24.1 million in profit. Arizona  
 16 Grain contends that in order to hold ratepayers harmless from paying two layers of profit on the work  
 17 performed by NPL, the estimated \$24.1 million profit earned by NPL should be removed from SWG's  
 18 rate base. In addition, Arizona Grain recommends that the Commission require the oversight of an  
 19 independent monitor for all awards of construction contracts.<sup>119</sup>

#### 20 RUCO

21 RUCO did not present argument relating to this proposed adjustment.

#### 22 Staff

23 Staff did not present argument relating to this proposed adjustment.

#### 24 Resolution

25 Although Arizona Grain claims that the "potential for abuse is substantial" given the size of the  
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27 <sup>116</sup> AG Cl. Br. at 19.

<sup>117</sup> *Id.* at 22.

<sup>118</sup> *Id.* at 19.

<sup>119</sup> *Id.* at 21-22.

1 Company's affiliated construction program, Arizona Grain offers no credible evidence showing that  
2 SWG acted inappropriately in awarding pipeline construction projects to NPL. To the contrary, SWG  
3 has presented evidence demonstrating that the Company utilized a competitive bidding process in  
4 awarding construction projects, and that NPL was the lowest bidder in those instances in which NPL  
5 was awarded contracts from SWG. Additionally, a fundamental guiding concept in utility ratemaking  
6 is that adjustments to rate base should be known and measurable. In this regard, we do not believe that  
7 Arizona Grain's hypothetical profit estimation meets that standard, even if we were to conclude that  
8 NPL's profits should offset SWG's rate base, which we do not. Based on the foregoing reasons, we  
9 decline to adopt Arizona Grain's proposed adjustment to remove affiliate profits.

10 **C. Original Cost Rate Base**

11 Based on the foregoing adjustments, we adopt an adjusted jurisdictional OCRB of  
12 \$1,930,611,851.

13 **D. Reconstruction Cost New Rate Base**

14 In Schedule B-1 of the Company's Final Schedules, SWG presents a jurisdictional RCND of  
15 \$3,308,392,886. All of the adjustments reflected in our determination of OCRB are equally applicable  
16 to the RCND. No changes to the adjustments are necessary to restate them in terms of reconstruction  
17 cost new. Accordingly, we adopt an adjusted jurisdictional RCND of \$3,173,182,227.

18 **E. Fair Value Rate Base**

19 The Commission has traditionally determined the "fair value" rate base by taking the average  
20 of the OCRB and RCND. No party has recommended that a different weighting be used in this  
21 proceeding. Based on the foregoing, we find that SWG's adjusted jurisdictional FVRB is  
22 \$2,551,897,039 for the purpose of this proceeding.

23 **F. The Fair Value Increment**

24 The FVI is the amount of FVRB in excess of OCRB, and reflects an amount not financed with  
25 investor-supplied funds. Based on the OCRB and FVRB adopted herein, we find that the Company's  
26 jurisdictional FVI is \$621,285,188.  
27  
28

1 **V. Operating Income**

2 **A. TY Revenue**

3 In its amended application, SWG proposed a jurisdictional TY operating revenue of  
4 \$518,218,363. No party opposed the Company's proposed TY revenue. Accordingly, we find that the  
5 Company's proposed TY revenue is reasonable and appropriate and adopt a TY operating revenue of  
6 \$518,218,363 for the purpose of this proceeding.

7 **B. TY Operating Expense**

8 **1. Depreciation Expense Adjustment – Durango Building**

9 Staff recommends excluding approximately \$75,000 in post-test year depreciation expense  
10 associated with the Durango building. For the reasons discussed more fully above to exclude the  
11 Durango Building from rate base,<sup>120</sup> we adopt Staff's recommendation.

12 **2. Depreciation Expense Adjustment – Post-Test Year System Allocable  
13 Error Account 303**

14 Staff recommends, and the Company agrees to, a corresponding rate base adjustment to reduce  
15 post-test year depreciation expense by approximately \$74,000 as a result of the System Allocable Error  
16 Account. For the reasons discussed more fully above,<sup>121</sup> we adopt Staff's recommendation.

17 **3. Private Corporate Aircraft Expense Adjustment**

18 SWG seeks to include in rates the jurisdictionally allocated TY operations and maintenance  
19 ("O&M") costs associated with owning and operating a private corporate aircraft in the amount of  
20 approximately \$325,000 as well as approximately \$185,000 in depreciation expense related to aircraft  
21 related plant and equipment.<sup>122</sup>

22 **SWG**

23 SWG asserts that its proposed costs associated with owning and operating a private corporate  
24 aircraft are reasonable and result in efficiencies and incidental cost-avoidances. In response to Arizona  
25 Grain, SWG asserts that Arizona Grain's estimated cost of flying commercially fails to account for the

26  
27 <sup>120</sup> See Section IV.B.1.d., *supra*.

28 <sup>121</sup> See Section IV.B.1.e., *supra*.

<sup>122</sup> The Company's private corporate aircraft expense includes aircraft dues, pilot labor, aircraft insurance, airplane maintenance, and fuel costs. Exh. RUCO-19 at 60.

1 additional costs that SWG avoids by flying privately. Specifically, SWG asserts that ratepayers benefit  
 2 from the Company's use of a private aircraft because flying private over commercial captures  
 3 efficiency savings (*e.g.*, the value of executive personnel time), as well as incidental cost savings (*e.g.*,  
 4 avoiding the costs of overnight lodging and meals). Further, SWG contends that Arizona Grain failed  
 5 to identify any specific costs related to the Company's private aircraft that were abnormal,  
 6 unreasonable, or that should otherwise result in an adjustment to TY expense. As a result, SWG  
 7 maintains that Arizona Grain's estimated cost of flying commercial should not be used to reduce the  
 8 Company's proposed TY corporate aircraft expense.<sup>123</sup>

9 Arizona Grain

10 Arizona Grain reviewed the Company's flight log information allocated to its Arizona  
 11 operations during the TY, and concluded that SWG utilized the private aircraft for approximately 273  
 12 passenger-hours. Arizona Grain notes that dividing the number of passenger-hours flown for Arizona  
 13 operations (273 hours) by the Company's total proposed TY private aircraft expense (approximately  
 14 \$700,000) results in a cost per passenger-hour of \$2,549.<sup>124</sup>

15 Arizona Grain asserts that the Company's proposed TY private aircraft expense is unreasonable  
 16 when compared to commercially available flights. According to Arizona Grain, commercial flights are  
 17 readily available between the Company's headquarters in Las Vegas, Nevada, and both major cities in  
 18 Arizona (Phoenix and Tucson). Arizona Grain analyzed the approximate cost of commercial flights  
 19 on Southwest Airlines to and from Arizona and determined that flying commercially during the TY  
 20 would cost SWG approximately \$48,000. As a result, Arizona Grain recommends that the Company's  
 21 TY expense for aircraft related costs be adjusted downward in the amount necessary to recognize the  
 22 costs of flying commercially.<sup>125</sup>

23 RUCO

24 RUCO argues that all TY corporate aircraft related costs be removed from the Company's  
 25

26 <sup>123</sup> SWG Reply Br. at 15-17.

27 <sup>124</sup> Arizona Grain determined that there were 19 flights carrying a total of 97 passengers for business relating to specifically  
 to its Arizona operations (or 177 passenger-hours); and 20 flights carrying a total of 75 passengers for business relating  
 generally to the business of the corporate board of directors (for a jurisdictionally-allocated 96 passenger-hours). AG Cl.  
 Br. at 56-57.

28 <sup>125</sup> AG Cl. Br. at 57-58.

1 proposed TY expense in this case. According to RUCO, “this proposed cost and alleged justification  
2 is the definition of corporate excess.”<sup>126</sup>

3 Staff

4 Staff recommends that the TY depreciation expense associated with the corporate aircraft be  
5 removed from TY expense. According to Staff, this adjustment corresponds with Staff’s  
6 recommendation to remove all corporate aircraft related plant and equipment from rate base. Staff did  
7 not make an adjustment for TY corporate aircraft O&M expense.<sup>127</sup>

8 Resolution

9 As discussed above, we find that the Company’s utilization of a private corporate aircraft to  
10 facilitate air travel for its executives and other accompanying SWG personnel is an unreasonable  
11 expense to include in rates.<sup>128</sup> However, we believe that a total disallowance of all TY air travel  
12 expense would represent an unreasonable adjustment. In this regard, we find that Arizona Grain’s  
13 proxy calculation to determine the estimated TY costs of flying commercial to conduct business  
14 relating to SWG’s Arizona operations is reasonable under the circumstances. Although SWG criticizes  
15 Arizona Grain’s calculation because it allegedly omits certain offsetting cost savings that result from  
16 flying private (*e.g.*, avoiding expenses associated with overnight lodgings and meals), SWG failed to  
17 provide evidence quantifying those purported cost savings. Based on the foregoing, we find that a  
18 reasonable and appropriate TY aircraft travel expense for SWG is \$47,792, and we adjust the  
19 Company’s proposed TY expense accordingly. In addition, and consistent with our decision to remove  
20 all corporate aircraft plant and equipment from rate base, we further adopt Staff’s recommendation to  
21 remove the corresponding TY depreciation expense.

22 **4. D&O Insurance Expense Adjustment**

23 SWG seeks to include in rates the TY jurisdictional costs attributable to D&O insurance  
24 expense in the amount of approximately \$475,000. Staff and RUCO recommend that the D&O  
25 insurance expense be adjusted 50 percent to recognize the shared benefit between ratepayers and  
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27 <sup>126</sup> RUCO Cl. Br. at 35.

28 <sup>127</sup> Staff Cl. Br. at

<sup>128</sup> See Section IV.B.3., *supra*.



1 shareholders.

2 For the reasons discussed more fully above,<sup>129</sup> we adopt the recommendations of Staff and  
3 RUCO to reduce the amount of the Company's proposed jurisdictional TY D&O liability insurance  
4 expense by 50 percent, or \$237,500.

5 **5. Anticipated Incremental O&M Costs Associated with the CDMI Project**  
6 **Expense Adjustment**

7 SWG

8 SWG proposes, as an alternative to its pending request for an accounting order in Docket No.  
9 G-01551A-19-0064 ("Accounting Order Docket"), an adjustment to O&M expense to capture  
10 approximately \$12.2 million in anticipated incremental O&M costs associated with the CDMI project  
11 through the end of 2021.<sup>130</sup> SWG proposed to normalize the recovery of those anticipated costs in rates  
12 over three years (or \$4.1 million per year), consistent with its estimated general rate case cycle.<sup>131</sup>

13 Arizona Grain

14 Arizona Grain did not present argument relating to this proposed adjustment.

15 RUCO

16 RUCO did not present argument relating to this proposed adjustment.

17 Staff

18 Staff argues that there is no legal basis to support the Company's proposed incremental O&M  
19 expense adjustment because none of these expenses have occurred during the TY, and the CDMI  
20 project is not yet operational.<sup>132</sup>

21 Resolution

22 We agree with Staff and find that the anticipated incremental O&M costs associated with the  
23 ongoing CDMI project, that will occur outside the TY, are inappropriate expenses to allow in rates at  
24 this time. Further, we note that the Accounting Order Docket is the more appropriate forum for  
25 discussing the issue of cost recovery associated with the ongoing CDMI project.<sup>133</sup>

26 <sup>129</sup> See Section IV.B.4., *supra*.

27 <sup>130</sup> Exh. SWG-24 at 38-39.

28 <sup>131</sup> SWG Cl. Br. at 15.

<sup>132</sup> Staff Cl. Br. at 6.

<sup>133</sup> See Docket No. G-01551A-19-0064.

1                   **6. Supplemental Executive Retirement Plan Expense Adjustment**

2           SWG seeks to include in rates the TY expense associated with an executive retirement plan, the  
3 Supplemental Executive Retirement Plan ("SERP"), at an annual jurisdictional cost of approximately  
4 \$1.8 million.

5           SWG

6           SWG argues that the SERP is part of the overall compensation package that SWG offers to  
7 attract qualified management and executive personnel. According to SWG, no party to this proceeding  
8 disagreed that the overall compensation package the Company provides to its employees is reasonable  
9 and in line with or below the compensation levels of other natural gas utilities. SWG contends that the  
10 Commission should allow recovery of the costs associated with the SERP because: 1) SERP is a  
11 prudently incurred cost; 2) SERP is a necessary cost of providing service because it is necessary to  
12 employ the Company's executives; 3) SERP is not supplemental compensation, but rather a program  
13 to restore executive compensation to the payout percentage levels of all other SWG employees; and 4)  
14 the Company's peers provide a SERP benefit to their executives.<sup>134</sup>

15           Arizona Grain

16           Arizona Grain took no position with respect to this adjustment.

17           RUCO

18           RUCO states that the SERP is a program offered to a select group of high-ranking officers in  
19 the Company, and is offered in addition to their regular retirement plan. According to RUCO, the  
20 Company's executives are already fairly compensated for their work and are provided multiple benefits  
21 including medical, dental, life and long-term disability insurance, and paid leave. RUCO maintains  
22 that the additional costs of the additional SERP retirement plan are not essential for the provision of  
23 gas service to customers, and the costs should be borne by shareholders, not ratepayers. As a result,  
24 RUCO argues that the SERP expense should be removed in its entirety. RUCO notes that the  
25 Commission disallowed SWG's proposed SERP expense in Decision No. 68487.<sup>135</sup>

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27  
28 <sup>134</sup> SWG Cl. Br. at 16-19.

<sup>135</sup> RUCO Cl. Br. at 21-22.

1        Staff

2        Staff explains that a SERP provides for retirement benefits in excess of the limits placed by the  
3        United States Internal Revenue Service ("IRS") regulations on pension plan calculations for salaries in  
4        excess of specified amounts. According to Staff, IRS restrictions can also limit the Company's 401(k)  
5        matching contributions such that the Company's contribution as a percent of salary may be smaller for  
6        highly paid executives. Staff argues that the SERP is limited to top executives and is not a cost  
7        necessary to the provision of gas utility service to customers. As a result, Staff recommends that the  
8        proposed SERP expense be disallowed in its entirety.<sup>136</sup>

9        Resolution

10       We agree with Staff and RUCO that the proposed SERP expense is not a cost necessary to the  
11       provision of gas utility service to customers. To the extent that the Company wishes to provide  
12       additional retirement benefits above the level permitted by IRS regulations applicable to all other  
13       employees, the Company may do so, but at the expense of its shareholders. Although the Company  
14       claims that other utilities provide SERP for competitive compensation, the Company has not shown  
15       that other public utility commissions more frequently than not approve recovery of SERP. In this  
16       regard, we note that if SERP compensation in other jurisdictions is not included in the revenue  
17       requirement, then allowing it in Arizona would have the same effect as granting an above-market rate  
18       of return to SWG. Accordingly, we find that it is reasonable and appropriate under the circumstances  
19       to disallow the recovery of SERP expense in rates at this time.

20                **7.        Executive Deferral Plan Expense Adjustment**

21        SWG seeks to recover in rates the TY expense associated with a Company matching  
22        contribution for its Executive Deferral Plan ("EDP"), at an annual jurisdictional cost of approximately  
23        \$100,000.

24        SWG

25        Like the SERP, SWG contends that the EDP is part of the overall compensation package that  
26        SWG offers to attract qualified management and executive personnel. According to SWG, no party to  
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28        <sup>136</sup> Staff Cl. Br. at 11-12.

1 this proceeding disagreed that the overall compensation package the Company provides to its  
 2 employees is reasonable and in line with or below the compensation levels of other natural gas utilities.  
 3 SWG maintains that the EDP is designed to bring executive's percentage of retirement investment  
 4 match in line with other Company employees. SWG states that for all the same reasons the Company  
 5 should be allowed full recovery of the SERP expense, SWG argues that the Commission should also  
 6 allow full cost recovery of the matching contribution portion of the EDP.<sup>137</sup>

7 Arizona Grain

8 Arizona Grain took no position with respect to this adjustment.

9 RUCO

10 RUCO states that it concurs with Staff's recommendation to exclude the Company matching  
 11 contribution component of the EDP. According to RUCO, the EDP represents an additional element  
 12 of executive compensation and its costs should not be borne by ratepayers.<sup>138</sup>

13 Staff

14 Staff explains that the EDP allows top executives to defer up to 100 percent of their annual  
 15 compensation and allows matching contributions from the Company. Staff states that it has no  
 16 concerns with the deferral aspect of the EDP; however, Staff argues that the Company matching  
 17 contribution aspect is problematic because participation is limited to top executives and constitutes  
 18 additional executive compensation. As a result, Staff recommends that the matching contribution for  
 19 the Company's EDP be disallowed in its entirety.<sup>139</sup>

20 Resolution

21 We agree with Staff and RUCO that the match component of the EDP is not a cost necessary  
 22 to the provision of gas utility service to customers. To the extent that the Company wishes to align an  
 23 executive's percentage of retirement investment match in line with other Company employees, the  
 24 Company may do so, but at the expense of its shareholders. Although the Company claims that other  
 25 utilities provide similar plans for competitive compensation, the Company has not shown that other  
 26 public utility commissions more frequently than not approve recovery of those supplemental plans. In

27 <sup>137</sup> SWG Cl. Br. at 19-20.

28 <sup>138</sup> RUCO Cl. Br. at 22.

<sup>139</sup> Staff Cl. Br. at 12.

1 this regard, we note that if similar supplemental compensation plans in other jurisdictions are not  
 2 included in the revenue requirement, then allowing those plans in Arizona would have the same effect  
 3 as granting an above-market rate of return for SWG. Accordingly, we find that it is reasonable and  
 4 appropriate under the circumstances to disallow the match component of the EDP in rates at this time.

### 5 **8. Management Incentive Plan Expense Adjustment**

6 SWG seeks to recover in rates the TY expense associated with a Management Incentive Plan  
 7 (“MIP”), at an annual jurisdictional cost of approximately \$4.8 million.

#### 8 SWG

9 Like the SERP and EDP, SWG contends that the MIP is part of the overall compensation  
 10 package that SWG offers to attract qualified management and executive personnel. According to SWG,  
 11 no party to this proceeding disagreed that the overall compensation package the Company provides to  
 12 its employees is reasonable and in line with or below the compensation levels of other natural gas  
 13 utilities.<sup>140</sup>

#### 14 Arizona Grain

15 Arizona Grain took no position with respect to this adjustment.

#### 16 RUCO

17 RUCO argues that the Commission should continue to recognize that MIP expense should be  
 18 shared equally between shareholders and ratepayers. As a result, RUCO submits that the proposed  
 19 MIP expense should be reduced by 50 percent, or approximately \$2.4 million.<sup>141</sup> RUCO generally  
 20 contends that the number of programs and amounts involved to reward highly paid SWG executives  
 21 beyond their base salaries are excessive. According to RUCO, the issue germane to its adjustment is  
 22 “not whether the program should be offered, but who should pay for it.”<sup>142</sup>

#### 23 Staff

24 Staff explains that the MIP is an annual incentive program that provides executives and other  
 25 management personnel with the opportunity to receive variable, at-risk pay, based upon the  
 26

27 <sup>140</sup> SWG Cl. Br. at 16-18.

28 <sup>141</sup> Exh. RUCO-19 at 11.

<sup>142</sup> RUCO Reply Br. at 4 (emphasis in original); RUCO Cl. Br. at 20-21.



1 achievement of certain benchmarks. The performance metrics for the MIP are: 1) Customer  
 2 Satisfaction (20 percent weight); 2) Safety (Damage) (10 percent weight); 3) Safety (Incident  
 3 Response) (10 percent weight); 4) O&M per customer (20 percent weight); and 5) Net Income (40  
 4 percent weight). According to Staff, the MIP is a long-standing SWG program and the Commission  
 5 has previously ordered that MIP expenses be shared between shareholders and ratepayers in past rate  
 6 cases.<sup>143</sup> Staff argues that the MIP expense should continue to be shared between shareholders and  
 7 ratepayers. Staff recommends that the MIP expense related to net income (40 percent weight) be  
 8 disallowed because that performance metric benefits shareholders, which results in a reduction to MIP  
 9 expense by approximately \$1.9 million. Staff further recommends a corresponding adjustment to  
 10 payroll tax expense and Medicare tax expense.<sup>144</sup>

#### 11 Resolution

12 We agree with Staff and RUCO that incentive compensation based on profitability benefits  
 13 shareholders and not ratepayers. As a result, we find that Staff's recommendation to disallow the 40  
 14 percent of the MIP related to net income is appropriate under the circumstances. Accordingly, we  
 15 adopt Staff's proposed adjustment to MIP expense as well as the corresponding adjustments to tax  
 16 expense.

### 17 **9. Restricted Stock/Unity Plan Expense Adjustment**

18 The Restricted Stock/Unity Plan ("RSUP") is designed to reward eligible Company personnel  
 19 with stock-based compensation for sustained performance over a three-year period. There are two  
 20 forms of awards granted annually, Performance Share Units ("PSUs") and time-vested Restricted Stock  
 21 Unity ("RSUs"). Executives are eligible for PSU and RSU awards, director-level employees are  
 22 eligible for RSU awards. SWG seeks to recover in rates the TY expense associated with the RSUP, at  
 23 an annual jurisdictional cost of approximately \$2.8 million.

24  
 25  
 26 <sup>143</sup> See Decision No. 70665 (December 24, 2008) (the Commission adopted Staff's recommendation to allow 50 percent of  
 27 the MIP expense); Decision No. 72723 (January 6, 2012) (the Commission limited MIP expense to 50 percent); Decision  
 28 No. 76069 (April 11, 2017) (the Commission adopted a settlement agreement that disallowed 20 percent of the MIP expense  
 related to SWG's return on equity).

<sup>144</sup> Staff Cl. Br. at 12-13.

1        SWG

2        Like the SERP, EDP, and MIP, SWG argues that its RSUP is part of the overall compensation  
3 package that SWG offers to attract qualified management and executive personnel. According to SWG,  
4 no party to this proceeding disagreed that the overall compensation package the Company provides to  
5 its employees is reasonable and in line with or below the compensation levels of other natural gas  
6 utilities.<sup>145</sup>

7        Arizona Grain

8        Arizona Grain took no position with respect to this adjustment.

9        RUCO

10       RUCO explains that the RSUP has two performance measures: 1) the Company's return on  
11 equity (weighted at 40 percent); and 2) the Company's three-year net income from gas sales (weighted  
12 at 60 percent). RUCO argues that the costs associated with the RSUP should be removed in their  
13 entirety because the program is exclusively tied to the Company's future financial results. As a result,  
14 RUCO submits that the cost of this program should be borne by shareholders.<sup>146</sup>

15       Staff

16       Staff maintains that the cost of providing stock-based compensation to officers and employees  
17 in excess of their other regular compensation should be borne by the shareholders. As a result, Staff  
18 recommends that the proposed RSUP expense be disallowed in its entirety. Further, Staff recommends  
19 a corresponding adjustment to payroll tax expense.<sup>147</sup>

20       Resolution

21       We find that the RSUP is exclusively tied to the Company's future financial results and that the  
22 associated costs should therefore be disallowed, as both Staff and RUCO recommend. To the extent  
23 that shareholders wish to compensate SWG management for its enhanced earnings, they may do so,  
24 but it is not appropriate for the utility's ratepayers to provide such incentive and compensation.  
25 Accordingly, we adopt the adjustment proposed by Staff and RUCO.

26  
27       <sup>145</sup> SWG Cl. Br. at 16-18.

28       <sup>146</sup> RUCO Cl. Br. at 23.

<sup>147</sup> Staff Cl. Br. at 14.

1                   **10.     Severance Pay Expense Adjustment**

2           SWG seeks to recover in rates the TY expense associated with employee severance payments,  
3 at an annual jurisdictional cost of approximately \$45,000.

4           SWG

5           SWG maintains that severance packages were offered during the TY to avoid the expense of  
6 defending future litigation which benefits customers by avoiding the larger increase in operating costs  
7 that might otherwise result.

8           Arizona Grain

9           Arizona Grain took no position with respect to this adjustment.

10          RUCO

11          RUCO argues that ratepayers should not be held responsible for severance pay of employees  
12 who resign or separate from the Company. According to RUCO, severance pay is not tied to any  
13 performance measure that benefits ratepayers, and only serves as extra compensation for select  
14 employees if they resign. As a result, RUCO recommends the removal of Company's severance pay  
15 expense and associated payroll tax.<sup>148</sup>

16          Staff

17          Staff took no position with respect to this adjustment.

18          Resolution

19          We find that the amount of the adjustment proposed by RUCO is immaterial, and therefore take  
20 no action with respect to that adjustment in this rate case.

21                   **11.     Investor Relations Expense Adjustment**

22          SWG seeks to recover in rates the costs associated with maintaining investor relations, at an  
23 annual jurisdictional cost of approximately \$560,000.

24          SWG

25          SWG argues that raising capital to support Company operations is an essential and reasonable  
26 expense. According to the Company, attracting and retaining investors is critical for the Company to  
27

28          

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<sup>148</sup> RUCO Cl. Br. at 24.

1 fund investment in Arizona infrastructure and operations. SWG maintains that there is no evidence in  
2 the record to support the disallowance of this expense.<sup>149</sup>

3 Arizona Grain

4 Arizona Grain took no position with respect to this adjustment.

5 RUCO

6 Although RUCO's Final Schedules adopt an adjustment to remove the Company's proposed  
7 investor relations expense in its entirety, RUCO's Closing Briefs did not provide argument to support  
8 that adjustment.

9 Staff

10 Staff took no position with respect to this adjustment.

11 Resolution

12 We note that investor relation expenses are necessary for large corporations with stock traded  
13 on exchanges. We further note that ratepayers benefit from SWG's access to equity capital. Since no  
14 party claims that the associated costs are unreasonable, we find that the Company's proposed investor  
15 relations expense is reasonable and should therefore be adopted.

16 **12. Industry Membership Dues Expense Adjustment**

17 SWG seeks to include in rates the costs of its membership dues in industry organizations, at an  
18 annual jurisdictional cost of approximately \$340,000.

19 SWG

20 SWG claims that ratepayers directly benefit from the Company's membership in various  
21 industry organizations. According to SWG, membership in industry organizations provides continuing  
22 educational opportunities relating to, among other things, underground pipeline safety and damage  
23 prevention. SWG notes that it reduced its proposed industry membership dues expense for amounts  
24 related to lobbying and legislative advocacy.<sup>150</sup>

25 Arizona Grain

26 Arizona Grain took no position with respect to this adjustment.

27  
28 <sup>149</sup> SWG Cl. Br. at 21.

<sup>150</sup> SWG Cl. Br. at 20.

1        RUCO

2        RUCO argues that a portion of industry dues paid by SWG should be disallowed because  
3 memberships in industry groups represent the interest of shareholders, membership is purely voluntary,  
4 many of the groups are political in nature, and membership may not be necessary for the provision of  
5 utility services to customers. RUCO recommends a disallowance of 50 percent of industry dues paid  
6 to American Gas Association (“AGA”), Western Energy Institute (“WEI”), and Common Ground  
7 Alliance (“CGA”), as well as a 100 percent disallowance of other dues not related to professional  
8 designations, for a total of approximately \$10,000.<sup>151</sup>

9        Staff

10       Staff took no position with respect to this adjustment.

11       Resolution

12       We note that reasonably incurred industry dues that are educational in nature, and not  
13 attributable to lobbying expenses, are an appropriate cost to attribute to ratepayers. Since the Company  
14 made an adjustment to remove the lobbying component of the costs associated with its industry  
15 membership dues,<sup>152</sup> we find that the Company’s proposed costs are reasonable and should therefore  
16 be adopted.

17                    **13.     Rate Case Expense Adjustment**

18       SWG seeks to recover in rates the costs associated with processing and litigating this rate case  
19 application, at a cost of \$471,000.

20       SWG

21       In response to RUCO, SWG argues that RUCO’s adjustment to remove \$71,000 from rate case  
22 expense is arbitrary and not based on evidence. SWG maintains that its proposed rate case expense is  
23 reasonable and should be amortized over a three-year period consistent with the Company’s anticipated  
24 general rate case cycle.<sup>153</sup>

27       <sup>151</sup> RUCO Cl. Br. at 24-27.

28       <sup>152</sup> Exh. RUCO-19 at 56.

<sup>153</sup> SWG Cl. Br. at 22.

1       Arizona Grain

2       Arizona Grain took no position with respect to this adjustment.

3       RUCO

4       RUCO argues that the Commission should limit rate case expense to \$400,000, which RUCO  
5 claims is reasonable and consistent with past rate case expense awards by the Commission. According  
6 to RUCO, the Company hired outside consultants to cover issues that could have been handled  
7 internally. Further, RUCO suggests that since the hearing was conducted remotely, the Company may  
8 have experienced savings associated with lodging, travel, and food costs.<sup>154</sup>

9       In the alternative, RUCO recommends that the Commission consider sharing the rate case  
10 expense equally between ratepayers and shareholders. RUCO states that it is generally concerned that  
11 rate case expense for utilities has been rising steadily over the years, and that ratepayers should not be  
12 expected to write a “blank check” to the Company to cover rate case expense.<sup>155</sup>

13       Staff

14       Staff took no position with respect to this adjustment.

15       Resolution

16       Although RUCO appears to claim that \$400,000 is a more reasonable expense to prosecute a  
17 rate case, RUCO does not provide any quantifiable evidence demonstrating that the Company’s  
18 proposed rate case expense is unreasonable. We note that the evidentiary hearing in this matter was  
19 fully contested, was held over the course of eight full days with RUCO’s full participation, and involved  
20 a Class A utility. Since there is no evidence showing that the proposed rate case expense is  
21 unreasonable, we adopt the rate case expense proposed by the Company. We further adopt the  
22 Company’s proposal to amortize rate case expense over three years as reasonable.

23       Further, RUCO’s alternative position that rate case expense be split between shareholders and  
24 ratepayers appears to be a novel approach, and one that has not previously been adopted by the  
25 Commission. We therefore decline to deviate from our previous regulatory treatment of including all  
26 reasonable costs associated with prosecuting a rate case in rates.

27 \_\_\_\_\_  
28 <sup>154</sup> RUCO Cl. Br. at 27-28; RUCO Reply Br. at 7.

<sup>155</sup> RUCO Cl. Br. at 27.



1                   **14. Other Miscellaneous Expense Adjustments**

2           RUCO objects to the following expenses proposed by the Company: \$11,800 in costs for  
3 financial and estate planning services provided to Company officers;<sup>156</sup> \$28,245 in costs to maintain  
4 two corporate apartments for use as temporary housing for new or relocated employees;<sup>157</sup> \$99,119 in  
5 employee relocation costs; and \$331,006 in car allowance stipends for upper-level management.<sup>158</sup>

6           SWG

7           SWG generally argues that expenses related to employee benefits are part of the overall  
8 compensation package that SWG offers to attract qualified management and executive personnel.<sup>159</sup>  
9 However, SWG did not specifically address RUCO's miscellaneous expense adjustments in its Closing  
10 Briefs.

11           Arizona Grain

12           Arizona Grain took no position with respect to RUCO's proposed adjustment.

13           RUCO

14           RUCO argues that the costs associated with the identified miscellaneous benefits expense are  
15 not necessary for the provision of safe and reliable gas service and should be removed from rates.

16           Staff

17           Staff took no position with respect to RUCO's proposed adjustment.

18           Resolution

19           The Company has failed to adequately explain how the Company's proposed car allowance  
20 stipend for upper-level management is reasonably related to the provision of gas utility service to  
21 ratepayers. We therefore find that the proposed car allowance stipend should be an expense attributed  
22 solely to shareholders. The remaining miscellaneous expense items identified by RUCO are  
23 immaterial; therefore, no further adjustments are warranted for the purpose of this case. Accordingly,  
24 we adopt RUCO's adjustment to remove the Company's proposed car stipend of \$331,006 from TY

25           <sup>156</sup> RUCO notes that four SWG executives exercised the financial and estate planning services benefit during the TY. RUCO  
26 further notes that SWG executives may only utilize this benefit every three years with a maximum benefit of \$5,000. Exh.  
RUCO-19 at 35.

27           <sup>157</sup> SWG indicated that it utilizes the corporate apartments for temporary housing for new or relocated employees until they  
can obtain permanent housing. Exh. RUCO-19 at 36.

28           <sup>158</sup> Exh. RUCO-19 at 35-37.

<sup>159</sup> SWG Cl. Br. at 19-20.

operating expense.

### C. Summary of Adjusted TY Operating Expense

Based on the foregoing, we find that the Company's adjusted TY operating expense is \$409,036,562 for the purpose of this proceeding.

### D. Summary of TY Operating Income

Based on the adoption of the foregoing adjustments, the following statement details the adjusted TY net operating income for ratemaking purposes:

Operating TY Revenue	\$518,218,363
Operating TY Expense (per SWG's Final Schedules)	\$418,440,423
Adjusted TY Operating Expense	\$409,036,562
Net TY Operating Income	\$109,181,801

## VI. Cost of Capital

The cost of capital compensates investors for the use of their capital to finance the plant and equipment necessary to provide utility service. There are generally three steps to determining the appropriate cost of capital in a rate case proceeding: 1) establishing the appropriate capital structure; 2) determining the appropriate cost of the utility's debt; and 3) establishing a reasonable cost of equity ("COE") for the utility.

### A. Capital Structure

SWG proposed to use its actual TY capital structure consisting of 48.90 percent long-term debt and 51.10 percent common equity. Arizona Grain, RUCO, and Staff initially accepted SWG's proposed TY capital structure.

During the hearing, Arizona Grain presented evidence of two debt issuances by SWG occurring after the TY: a \$300 million debt issuance in May of 2019, yielding 4.15 percent interest; and a \$450 million debt issuance in June of 2020, yielding 2.20 percent interest (collectively, "Post-Test Year Debt"). SWG was subsequently ordered to provide updated schedules documenting the Company's

capital structure as of August 7, 2020.<sup>160</sup> Based on the Company's updated schedules, the issuances of Post-Test Year Debt resulted in an adjusted capital structure of 50.80 percent long-term debt and 49.20 percent equity as of June 30, 2020 ("Post-Test Year Capital Structure").

#### SWG

SWG asserts that the Post-Test Year Capital Structure should not be relied upon because it reflects only a temporary increase in debt leverage. As explained by SWG, debt issuances are generally characterized as "lumpy" because there is a minimum issuance size of \$300 million to achieve the best pricing; common equity increases on the other hand, can be spread out during the year via equity issuances.<sup>161</sup> According to the Company, SWG Parent has disclosed in regulatory filings that it will issue between \$500 to \$675 million in additional common equity during the three-year period ending December 31, 2022, with \$150 to \$200 million to be issued in 2020. SWG maintains that a "good portion" of the contemplated equity issuances will be used to fund its capital expenditures.<sup>162</sup> As a result, SWG argues that the Company's capital structure as of June 30, 2020, is neither representative of the capital structure used by SWG to fund rate base from the beginning of the TY through June 30, 2020, nor the capital structure that will exist during the period new rates approved in this proceeding are in effect.<sup>163</sup>

SWG further asserts that reliance on the Post-Test Year Capital Structure violates the Commission's historical test year convention and defies long-standing ratemaking principles. SWG argues that the Post-Test Year Capital Structure is inappropriate because it "cherry-picks" certain ratemaking items after the test year (*i.e.* the debt and equity components of capital structure) without considering the Company's entire cost of service.<sup>164</sup> According to SWG, updating a utility's capital structure should not be asymmetric in nature, particularly where it is only used to reduce revenue requirement. SWG argues that adoption of the Post-Test Year Capital Structure would create a mismatch in the ratemaking process where the goal is to establish rates that are representative of the

<sup>160</sup> By Procedural Order dated August 7, 2020, SWG was ordered to calculate and file updated cost of capital schedules to incorporate the Post-Test Year Debt no later than August 12, 2020. On August 12, 2020, the Company filed updated capital structure schedules.

<sup>161</sup> SWG Cl. Br. at 43.

<sup>162</sup> *Id.* at 45.

<sup>163</sup> *Id.* at 43-44.

<sup>164</sup> *Id.* at 45.

1 costs that will be incurred during the period that rates are in effect.<sup>165</sup>

2 Moreover, SWG asserts that reliance on the Post-Test Year Capital Structure would result in  
3 impermissible single-issue ratemaking. SWG maintains that impermissible single-issue ratemaking  
4 generally occurs when the Commission fails to consider the fair value of a utility's plant and property  
5 in the determination of formulating rates. According to SWG, the Commission is without authority to  
6 change a rate without first determining the fair value of the utility's rate base and the overall impact of  
7 the increase on the utility's return. SWG argues that the Commission would be unable to determine  
8 the Company's fair value if the Post-Test Year Capital Structure is adopted because that updated capital  
9 structure does not contain an update of the entire cost of service.<sup>166</sup>

10 SWG further argues that allowing post-test year adjustments to a utility's capital structure could  
11 "create the unintended consequence of limiting a utility's flexibility to finance its operations...[and]  
12 also create undue risk for abuse and manipulation."<sup>167</sup> SWG claims that if adjustments to test year  
13 capital structures are consistently applied, utilities could complete financings or changes in capital  
14 structure near the end of the proceeding, resulting in a higher revenue requirement. SWG further claims  
15 that if capital costs are lower, utilities may postpone financings and forego opportunities to issue debt  
16 when market conditions are favorable.<sup>168</sup>

17 SWG contends that the Post-Test Year Capital Structure lacks probative evidentiary value upon  
18 which to establish rates because it reflects a partially updated capital structure that is roughly 17-months  
19 beyond the end of the test year. SWG maintains that absent a corresponding update to the Company's  
20 entire cost of service, the information contained in the Post-Test Year Capital Structure is both  
21 misleading and prejudicial. Moreover, SWG claims that the evidentiary record is void of any testimony  
22 or other evidence as to: the appropriateness of the updated capital structure for ratemaking purposes;  
23 any adjustments to the capital structure given the specific circumstances at the point of update; or any  
24 impact on the ROE. As a result, SWG argues that the Post-Test Year Capital Structure should not be  
25 adopted by the Commission.<sup>169</sup>

26 <sup>165</sup> *Id.* at 44-46.

27 <sup>166</sup> SWG Cl. Br. at 46.

27 <sup>167</sup> *Id.* at 47.

28 <sup>168</sup> *Id.*

<sup>169</sup> *Id.*

1 SWG opposes Arizona Grain's recommendation that the Company be required to file an  
 2 updated embedded cost of long-term debt on an annual basis. Specifically, SWG argues that the  
 3 reasoning behind Arizona Grain's recommendation is faulty for two reasons. First, SWG contends that  
 4 Arizona Grain's reference to an article discussing how the Federal Reserve will likely hold interest  
 5 rates low for many years is misleading because the Federal Reserve affects short-term rates, not long-  
 6 term rates. Rather, SWG states that "long-term [interest] rates are primarily driven by expectations of  
 7 economic growth and inflation."<sup>170</sup> According to SWG, any claim that the Company's cost of long-  
 8 term debt will remain low based on the expectations of a lower federal funds rate is unsupported and  
 9 purely speculative.<sup>171</sup>

10 Second, SWG contends that Arizona Grain's position that the Company's existing debt has call  
 11 provisions that could allow SWG to refund the debt at lower rates is incorrect. According to SWG,  
 12 "the Company's outstanding debt does not contain call options that provide the Company with the  
 13 ability to redeem debt early and refinance at lower rates in an economic manner."<sup>172</sup> As a result, SWG  
 14 claims that Arizona Grain's recommended annual cost of long-term debt filing should be rejected.  
 15 Notwithstanding the foregoing, SWG notes that the Company would consider and is willing to work  
 16 with interested stakeholders to develop an annual cost of capital adjustment mechanism through a  
 17 generic workshop.<sup>173</sup>

18 Arizona Grain

19 Arizona Grain contends that the Post-Test Year Capital Structure should be adopted because it  
 20 is based on the latest known and measurable data. Arizona Grain notes that the Post-Test Year Debt  
 21 incorporated into the Post-Test Year Capital Structure would both lower the Company's TY embedded  
 22 long-term cost of debt and increase the TY long-term debt component of the Company's weighted  
 23 average cost of capital ("WACC"), both of which directly affect the ultimate revenue requirement  
 24 borne by ratepayers. Based on Arizona Grain's calculations, adoption of the Post-Test Year Capital  
 25 Structure would decrease the Company's requested revenue increase by approximately \$9.8 million.<sup>174</sup>

26 <sup>170</sup> SWG Reply Br. at 42.

27 <sup>171</sup> *Id.* at 42-43.

27 <sup>172</sup> *Id.* at 43.

28 <sup>173</sup> *Id.*

<sup>174</sup> AG Cl. Br. at 39-41.

1 Arizona Grain further contends that updates to the Company's TY capital structure and WACC are  
2 reasonable given the current extraordinary circumstances associated with the COVID-19 pandemic.<sup>175</sup>  
3 According to Arizona Grain, "[i]f the FVROR is set higher than SWG's actual fair value WACC, then  
4 [SWG] would be provided an artificial cushion, again making overearning a real possibility."<sup>176</sup>

5 Arizona Grain asserts that SWG's argument that updating the capital structure would depart  
6 from historic test-year ratemaking is "ironic" given that SWG is requesting to update its rate base with  
7 PTYP, and is seeking other forward projecting accounting mechanisms.<sup>177</sup> Additionally, Arizona Grain  
8 notes that SWG is also proposing post-test year adjustments to expenses, including employee  
9 compensation.

10 Arizona Grain further argues that requiring SWG to update its capital structure and WACC is  
11 consistent with the Commission's requirement to update rates for reduced federal income taxes.  
12 Arizona Grain submits that requiring SWG to refund federal income taxes based on a known and  
13 measurable change to the federal corporate tax rate is analogous to requiring SWG to update its capital  
14 structure based on current known and measurable changes outside the test year. Arizona Grain  
15 maintains that fairness requires rates be set based on known and measurable changes to the capital  
16 structure, which will result in lower rates to ratepayers.<sup>178</sup>

17 Arizona Grain also argues that requiring SWG to update its capital structure and WACC is  
18 consistent with Staff's position in its recent rate review of Arizona Public Service Company  
19 ("APS").<sup>179</sup> In that case, Staff determined that the embedded cost of long-term debt in APS's 2016 rate  
20 case is higher than the current cost of long-term debt; Staff therefore recommended that APS file a rate  
21 case sooner rather than later to incorporate the lower current cost of long-term debt. Arizona Grain  
22 claims that the APS case highlights the importance of incorporating the current embedded cost of debt  
23 reflected in rates "sooner rather than later."<sup>180</sup>

24 In order to monitor SWG's long-term cost of debt, Arizona Grain recommends that SWG be  
25

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26 <sup>175</sup> AG Cl. Br. at 42.

27 <sup>176</sup> *Id.* at 44.

28 <sup>177</sup> *Id.* at 41.

<sup>178</sup> *Id.* at 42.

<sup>179</sup> See Docket No. E-01345A-19-0003.

<sup>180</sup> AG Cl. Br. at 44-45.



1 directed to file an updated capital structure with the embedded long-term cost of debt on an annual  
 2 basis. As support, Arizona Grain submits an article discussing the Federal Reserve's expectation to  
 3 keep interest rates "for many years," as well as a Data Request Response from SWG purporting to  
 4 demonstrate that SWG's existing debt contains call provisions that would allow SWG to refund its debt  
 5 at much lower rates.<sup>181</sup> According to Arizona Grain, the annual filing will allow the Commission to  
 6 consider adjusting rates based on reduced capital costs.<sup>182</sup>

### 7 RUCO

8 Although RUCO's Closing Brief argues that its proposed FVROR is based on the Company's  
 9 TY capital structure,<sup>183</sup> RUCO's Final Schedules submitted in this matter reflect the adoption of the  
 10 Post-Test Year Capital Structure.

### 11 Staff

12 Staff is in agreement with the Company's proposed TY capital structure.<sup>184</sup>

### 13 Resolution

14 We note that SWG's suggestion that adjusting a utility's capital structure within the confines  
 15 of a general rate case constitutes single-issue ratemaking is misplaced. Although the prohibition  
 16 against single-issue ratemaking precludes the Commission, in certain instances, from adjusting rates in  
 17 between rate cases, single-issue ratemaking is not applicable when the Commission is determining fair  
 18 value in the context of a utility's general rate case.<sup>185</sup> In this case, the Commission is considering the  
 19 Company's fair value rate base in the context of setting just and reasonable rates for SWG. To  
 20 accomplish that constitutional obligation, the Commission has the authority and discretion to consider  
 21 and determine known and measurable ratemaking adjustments that will result in just and reasonable  
 22 rates. Further, the logical extension of SWG's argument that adjusting capital structure based on  
 23 known and measurable changes constitutes single-issue ratemaking applies equally to the Company's  
 24 own request to adjust rate base to include known and measurable changes to PTYP.

25 Although the Commission has the discretion and authority to adjust the Company's proposed

26 <sup>181</sup> AG Cl. Br. at Exhibit A.

27 <sup>182</sup> *Id.* at 72.

28 <sup>183</sup> RUCO Cl. Br. at 14.

<sup>184</sup> Staff Cl. Br. at 2.

<sup>185</sup> See *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531 (1978).

1 capital structure, we agree with SWG and Staff that adopting the Company's proposed TY capital  
2 structure comprised of 51.10 percent common equity and 48.90 percent long-term debt is appropriate  
3 under the circumstances of this proceeding. We find that the TY capital structure proposed by SWG  
4 and Staff is reasonable and appropriate because it is the capital structure existing at the end of the TY,  
5 and will establish rates that are more representative of the costs that will be incurred during the period  
6 that rates are in effect.

7 **B. Cost of Debt**

8 SWG proposed an embedded cost of long-term debt of 4.86, based on the end of the TY. SWG  
9 and Staff are in agreement that the Commission should adopt the TY cost of debt of 4.86 percent.<sup>186</sup>  
10 Arizona Grain and RUCO propose a cost of debt of 4.28 percent, which incorporates the yields on the  
11 Post-Test Year Debt issuances reflected in the Post-Test Year Capital Structure.

12 Resolution

13 As discussed above, we do not believe it is appropriate to adopt the Post-Test Year Capital  
14 Structure proposed by Arizona Grain and RUCO.<sup>187</sup> We therefore decline to incorporate the additional  
15 Post-Test Year Debt into the Company's total cost of debt. Accordingly, we adopt an embedded cost  
16 of long-term debt of 4.86 percent for the purpose of this proceeding.

17 **C. Cost of Equity**

18 Unlike cost of debt, the COE cannot be observed directly because it is a function of the returns  
19 available from other investment alternatives and the risks to which the equity capital is exposed. The  
20 COE therefore must be estimated by analyzing information about capital market conditions, assessing  
21 company specific risks, and using various qualitative models and methods to determine investors'  
22 required return on equity ("ROE"). Since SWG is not a publicly traded company, and because the cost  
23 of capital is a prospective opportunity cost, the COE must be estimated.

24 SWG, Arizona Grain, RUCO, and Staff all presented expert witnesses to evaluate COE based  
25 on their understanding of the economic, financial, and legal principles that underlie the concept of fair  
26 value rate of return for a public utility. All of the expert witnesses agreed that no one single model or  
27

28 <sup>186</sup> Staff Cl. Br. at 2.

<sup>187</sup> See Section VI.A., *supra*.

method should be used to estimate a utility's COE. To that end, the expert witnesses in this proceeding utilized a combination of the following models and methodologies: the Discounted Cash Flow Model ("DCF"); the Capital Asset Pricing Model ("CAPM"); the Risk Premium Model ("RPM"); the Expected Earnings Method ("EEM"); and the Comparable Earnings ("CE") method. Their recommendations are as follows:

<u>Party</u>	<u>COE Range</u>	<u>Recommendation</u>
SWG (Hevert)	10.00 to 10.75%	10.15%
Arizona Grain (Woolridge)	7.50 to 8.80%	8.75% <sup>188</sup>
RUCO (Cassidy)	8.43 to 9.20%	9.15% <sup>189</sup>
Staff (Parcell)	9.10 to 9.50%	9.30%

SWG

SWG's expert witness, Mr. Hevert, testified that he estimated a cost of common equity for SWG by utilizing the Constant Growth DCF, CAPM, Bond Yield Plus RPM, and EEM using a proxy group of seven publicly traded natural gas distribution utilities. Mr. Hevert's DCF analysis showed a return on equity in the range of 9.60 to 12.40 percent; his CAPM analysis showed a return on equity in the range of 10.25 to 12.50 percent; his Bond Yield Plus Risk RPM analysis showed a return on equity in the range of 9.90 to 10.10 percent; and his EEM analysis showed a return on equity in the range of 10.10 and 12.10 percent.<sup>190</sup>

Based on the results of his financial models, Mr. Hevert concluded that SWG's COE falls within a range of 10.0 and 10.75 percent. In addition to analyzing results of his models, Mr. Hevert testified that he reviewed: SWG's capital spending plan; SWG's regulatory risk relative to the proxy group, specifically SWG's decoupling mechanism (the DCA); evolving capital market and business conditions; and the cost of issuing additional shares of common stock. Based on the totality of his quantitative and qualitative analyses, Mr. Hevert concluded that a return on equity of 10.15 percent is

<sup>188</sup> Mr. Woolridge further recommends a downward adjustment of at least 15 basis points in the event that the Commission approves the Company's request to continue its decoupling mechanism. Exh. AG-1 at 66-67.

<sup>189</sup> Mr. Cassidy further recommends a downward adjustment of 15 basis points in the event that the Commission approves the Company's request to continue its decoupling mechanism. Exh. RUCO-24 at 3.

<sup>190</sup> Exh. SWG-7 at 7-8.

1 reasonable under the circumstances.<sup>191</sup>

2       SWG contends that a utility's regulatory environment and resulting level of regulatory risk are  
3 important factors considered by credit rating agencies and investors. SWG states that the use of  
4 regulatory mechanisms and adjustment clauses are common in Mr. Hevert's proxy group, and notes  
5 that the average proxy group credit agency rating is higher than the Company's.<sup>192</sup> According to SWG,  
6 the Company's lower credit rating is reflective of a higher level of regulatory risk relative to the proxy  
7 group.<sup>193</sup> SWG argues generally that higher regulatory risk requires a higher return on equity to  
8 compensate investors for that additional risk.

9       SWG further contends that maintaining the Company's financial integrity, as measured by its  
10 current credit ratings, is critically important to the Company's overall cost of capital, which is paid by  
11 customers. According to SWG, a single "A" credit rating for regulated utilities has generally been  
12 found to minimize the long-run average pre-tax cost of capital paid by customers. SWG states that  
13 "[h]aving a financially healthy utility with a strong investment credit rating is beneficial to customers,  
14 as the cost of capital, which includes the cost of both debt and equity, is embedded in the rates  
15 customers pay."<sup>194</sup>

16       SWG also argues that the COVID-19 global pandemic has impacted the Company's current  
17 estimated cost of capital by significantly disrupting the current and expected economic environment  
18 and capital market conditions. SWG contends that when long-term U.S. Treasury yields fell to  
19 historically low levels as a result of the pandemic, utility stock prices also continued to decline,  
20 reflecting higher required returns. As a result, SWG states that "there is no question that the equity  
21 market, including the utility sector, is riskier now than it was prior to mid-February."<sup>195</sup> SWG asserts  
22 that since the estimated cost of common equity is currently higher than it was prior to the COVID-19  
23 pandemic, Mr. Hevert's proposed return on equity of 10.15 percent, which is based on his COE range  
24

25 <sup>191</sup> *Id.* at 5-6. SWG initially proposed a return on equity of 10.3 percent; however, in recognition of the Company's currently  
26 authorized ROE of 9.5 percent, and in an effort to mitigate the financial impacts to customers, Mr. Hevert testified that  
27 SWG reduced its proposed return on equity to 10.15 percent. Exh. SWG-8 at 2.

28 <sup>192</sup> Mr. Hevert testified that the proxy group had an average credit rating of A2 from Moody's (compared to A3 for SWG),  
and an average credit rating of A- from S&P (compared to BBB+ for SWG). Exh. SWG-7 at Exh. RBH-11.

<sup>193</sup> SWG Cl. Br. at 35.

<sup>194</sup> *Id.* at 37-38.

<sup>195</sup> *Id.* at 35-36.

1 developed prior to the pandemic,<sup>196</sup> is reasonable and should be adopted by the Commission.

2 In response to Mr. Woolridge's cost of capital analysis on behalf of Arizona Grain, SWG asserts  
3 that the primary areas of disagreement between SWG and Arizona Grain relating to cost of capital are:

- 4 • The incorrect analysis of the effect of current and expected capital market conditions on SWG's  
5 ROE;
- 6 • The reasonableness of SWG's ROE analysis;
- 7 • The faulty composition and selection of proxy companies;
- 8 • Arizona Grain's application of the Constant Growth DCF Model;
- 9 • Arizona Grain's application of the CAPM;
- 10 • The reasonableness of the Bond Yield Plus Risk Premium Analysis;
- 11 • Arizona Grain's erroneous argument that the Expected Earnings approach is not an accurate  
12 measure of investor expectations;
- 13 • The relevance of market to book ratios in determine ROE;
- 14 • Arizona Grain's flawed conclusion that the Company is less risky than its peers; and
- 15 • Arizona Grain's proposed 15 basis point downward adjustment to ROE for decoupling is  
16 inappropriate and unsupported<sup>197</sup>

17 In response to Mr. Cassidy's cost of capital analysis on behalf of RUCO, SWG argues that the  
18 primary areas of disagreement between SWG and RUCO are:

- 19 • The incomplete and erroneous analysis of the effect of current market conditions on the  
20 Company's ROE;
- 21 • The growth rates used in RUCO's DCF analysis;
- 22 • The application of the CAPM model;
- 23 • The application of the CE method; and
- 24 • RUCO's proposed 15 basis point downward adjustment to ROE for decoupling is inappropriate  
25 and unsupported.<sup>198</sup>

26 <sup>196</sup> Mr. Hevert's COE analysis was set forth in his direct testimony filed on May 1, 2019 (Exh. SWG-7). Mr. Hevert  
27 provided updates to his direct testimony through rebuttal testimony filed on March 11, 2020 (Exh. SWG-8) and rejoinder  
testimony filed on April 21, 2020 (Exh. SWG-9).

28 <sup>197</sup> SWG Cl. Br. at 38-39.

<sup>198</sup> *Id.* at 38.

1 In response to Mr. Parcell's cost of capital analysis on behalf of Staff, SWG argues that the  
2 primary areas of disagreement between SWG and Staff are:

- 3 • The discussion of current market conditions in Staff's testimony incorrectly suggests that there  
4 has been a reduction in equity returns since 2009;
- 5 • The inclusion of SWG Parent in the proxy group;
- 6 • The historical data and growth rates used in the DCF analysis;
- 7 • The application of the CAPM;
- 8 • The subjective application of the CE method, which forms the upper end of Mr. Parcell's  
9 recommended range and therefore significantly impacts his recommendation;
- 10 • The faulty application of the Risk Premium analysis, which ignores the inverse relationship  
11 between risk premium and interest rates; and
- 12 • The erroneous conclusion that additional risk factors should not be considered for SWG because  
13 they are already represented in the proxy group.<sup>199</sup>

14 SWG contends that Arizona Grain and RUCO's proposed downward adjustment to ROE to  
15 capture reduced risk from decoupled rates is inappropriate and unsupported by the record. SWG states  
16 that "every company in [SWG's] proxy group is decoupled, and there is no state regulatory  
17 [c]ommission in the country that is currently making downward adjustments to natural gas utility ROEs  
18 due to decoupling."<sup>200</sup> According to SWG, regulatory commissions have concluded that given the  
19 prevalence of decoupling and other rate stabilization mechanisms, any risk reduction is already  
20 reflected in the capital market data used by the parties in this proceeding to estimate the cost of common  
21 equity for SWG. As a result, SWG maintains that recognizing a downward adjustment to ROE based  
22 on a decoupled rate structure "would place [SWG] at a significant disadvantage relative to other gas  
23 utilities in terms of capital attraction and would place additional downward pressure on the Company's  
24 credit rating."<sup>201</sup>

25 SWG further contends that the ROE recommendations presented by the other parties are unduly  
26 low and problematic. SWG notes that the average authorized ROEs for gas utilities in 2019 was 9.70

27 <sup>199</sup> SWG Cl. Br. at 38.

28 <sup>200</sup> *Id.* at 39.

<sup>201</sup> *Id.* at 40.



1 percent, and SWG's currently authorized ROE is 9.50 percent.<sup>202</sup> SWG claims that regulatory stability  
2 and supportiveness are important to investors and creditors. For example, SWG notes that Moody's  
3 places 50 percent of the weight that it applies in determining credit ratings on issues surrounding the  
4 regulatory framework and the ability of a utility to recover costs and earn returns. Moreover, SWG  
5 maintains that volatile market conditions make regulatory supportiveness even more important.  
6 According to SWG, "the adoption of any of the ROEs recommended by the other parties would only  
7 add to the risks posed by the extraordinarily volatile market conditions currently being experienced"  
8 as a result of the pandemic.<sup>203</sup>

9 Arizona Grain

10 Arizona Grain's expert witness, Mr. J. Randall Woolridge, testified that he relied on the  
11 Constant Growth DCF and the CAPM methodologies to estimate an appropriate COE for SWG using  
12 a proxy group of nine publicly traded natural gas distribution utilities.

13 Mr. Woolridge's DCF model assumes that dividends are expected to grow at a constant rate.  
14 Mr. Woolridge calculated the expected dividend yield based on the reported dividend yields for his  
15 proxy group. Mr. Woolridge also measured several measures of growth for companies in the proxy  
16 group, including Value Line's historical and projected growth rate estimates for earnings per share  
17 ("EPS"), dividends per share ("DPS"), and book value per share ("BVPS"). Further, Mr. Woolridge  
18 assessed prospective growth as measured by prospective earnings retention rates and earned returns on  
19 common equity. After applying his DCF formula, Mr. Woolridge calculated an 8.80 percent equity  
20 cost rate.<sup>204</sup>

21 Mr. Woolridge's explained that his CAPM method is a risk premium approach to gauging a  
22 firm's cost of equity capital. Mr. Woolridge relied on three inputs to estimate the required return or  
23 COE: 1) the risk-free rate of interest which is represented by the yield on long-term U.S. Treasury  
24 bonds; 2) the beta coefficient which reflects the measure of the systematic risk of a stock; and 3) the  
25 expected equity or market-risk premium. Based on his CAPM analysis, Mr. Woolridge's calculated a  
26

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27 <sup>202</sup> SWG Reply Br. at 25.

28 <sup>203</sup> *Id.* at 26.

<sup>204</sup> AG Cl. Br. at 28-29.

1 7.50 percent equity cost rate.<sup>205</sup>

2 Based on his COE analyses, Mr. Woolridge concluded that SWG's COE falls within a range of  
3 7.50 to 8.80 percent, and proposed a return on equity of 8.75 percent as most appropriate. Mr.  
4 Woolridge testified that his proposed return on equity is on the higher end of his range because he  
5 relied primarily the results of the DCF model. According to Mr. Woolridge, his return on equity  
6 recommendation accurately reflects current capital market data, and is also reflective of the current  
7 capital market environment with historically low inflation, interest rates, and capital costs.<sup>206</sup> In the  
8 event that the Commission allows SWG to continue revenue decoupling, Mr. Woolridge recommends  
9 that the Commission apply a downward adjustment of at least 15 basis points to the authorized ROE to  
10 account for reduced risk.<sup>207</sup>

11 Mr. Woolridge testified that he identified a number of errors with respect to Mr. Hevert's COE  
12 analysis and conclusion. Specifically, Mr. Woolridge argues that:

- 13 • Mr. Hevert's recommendation is out of date because it neither reflects the fact that long-term  
14 U.S. Treasury rates have fallen 70-basis points nor that the Federal Reserve has cut the federal  
15 funds rate three times since the filing of the Company's rate case;
- 16 • Mr. Hevert's testimony and resulting recommendation are based on incorrect assumptions of  
17 higher interest rates and capital costs;
- 18 • SWG's credit ratings indicate that the Company's investment risk is less than the average of  
19 the gas proxy group as well as that of SWG Parent;
- 20 • Mr. Hevert has not given appropriate weight to his Constant Growth DCF results;
- 21 • Mr. Hevert's CAPM results are based on projected interest rates that are well above current  
22 rates and market risk premiums that include highly unreasonable projections and assumptions  
23 about future earnings growth relative to gross domestic product ("GDP") growth;
- 24 • Mr. Hevert's EEM approach does not measure the cost of equity capital because "[that]  
25 approach is an accounting-based methodology that does not measure investor return  
26

27 <sup>205</sup> AG Cl. Br. at 31-32.

28 <sup>206</sup> Exh. AG-1 at 59-61; AG Cl. Br. at 33.

<sup>207</sup> Exh. AG-1 at 5, 66-67.

requirements, and therefore it does not measure the market cost of equity capital;<sup>208</sup>

- Mr. Hevert's Bond Yield Plus RPM results are based on projected interest rates that are well above current rates and a risk premium that is not based on investors and markets, but rather on the behavior of regulatory commissions; and
- A downward adjustment is warranted if the Commission continues fully decoupled rates for SWG because the Company's fully decoupled rates would apply to 90 percent of the Company's revenue and gas volumes, a percentage that is much higher than utilities with decoupled rates in the proxy group.<sup>209</sup>

Mr. Woolridge further testified that Mr. Parcell's COE recommendation of 9.30 percent is well-above the COE indicated by the results of his models. Specifically, Mr. Woolridge argues that:

- Mr. Parcell misstated the results of his DCF analysis by reporting only the mean high and median high DCF equity cost rates instead of the mean and median results;
- Mr. Parcell completely ignored the results of his CAPM study, which include a mean and median COE of 6.0 percent and 5.9 percent, respectively;
- Mr. Parcell misstated the results of his RPM approach by using the yields on utility bonds that have a lower credit rating than SWG; and
- Mr. Parcell appeared to give almost 100 percent weight to the results of his CE approach, which (unlike the DCF, CAPM, and RPM approaches) is not a generally recognized approach to estimating the COE capital.<sup>210</sup>

#### RUCO

RUCO's expert witness, Mr. John Cassidy, obtained common equity cost estimates for a proxy group of seven publicly traded natural gas distribution utilities from three COE estimation models: the Constant Growth DCF Model; the CAPM; and the CE approach. Based on his COE analyses, Mr. Cassidy concluded that SWG's COE falls within a range of 8.30 to 9.89 percent, and he proposed a COE of 9.15 percent for SWG.<sup>211</sup> In the event that the Commission authorizes SWG to continue its

<sup>208</sup> Exh. AG-2 at 17.

<sup>209</sup> Exh. AG-1 at 7-12.

<sup>210</sup> Exh. AG-2 at 37; AG Cl. Br. at 37-38.

<sup>211</sup> Exh. RUCO-24 at 2-3.

1 decoupling mechanism, Mr. Cassidy further recommends that the Commission apply a downward  
2 adjustment of 15 basis points to the authorized ROE to account for reduced risk.<sup>212</sup>

3 Mr. Cassidy's DCF results showed a COE in the range of 8.30 to 9.89 percent, with a 9.06  
4 midpoint; his CAPM results showed a COE in the range of 6.36 to 6.52 percent, with a 6.44 percent  
5 midpoint; and his CE approach showed COE in the range of 8.50 to 9.80 percent, with a midpoint of  
6 9.15 percent. Mr. Cassidy testified that RUCO did not directly incorporate the equity cost estimates  
7 obtained from the CAPM into its proposed COE because the CAPM results continue to be low relative  
8 to the estimates derived from the DCF and CE approaches. Testifying further, Mr. Cassidy explained  
9 that the estimates obtained from the CAPM are generally indicative of a continuing decline in the cost  
10 of capital, including the cost of common equity capital.<sup>213</sup>

11 Mr. Cassidy testified that Mr. Hevert's proposed COE overstates the Company's actual COE  
12 because Mr. Hevert's analysis fails to consider that interest rates and the cost of capital will continue  
13 to remain low as a result of the COVID-19 pandemic due to: muted inflation; a precipitous rise in  
14 unemployment; a shut-down of the global economy that will likely lead to a global recession; and the  
15 unlikely prospect of rising GDP growth.<sup>214</sup>

16 RUCO argues that the Commission should not give any weight to the results of Mr. Hevert's  
17 EEM and Bond Yield Plus RPM approaches because "[t]he DCF has historically been relied upon by  
18 the Commission" as well as the Federal Energy Regulatory Commission ("FERC").<sup>215</sup> According to  
19 RUCO, the DCF model has "been around the longest" and is "the only model that takes into  
20 consideration the price an investor must pay for a given unit of return."<sup>216</sup> Moreover, RUCO noted that  
21 FERC recently rejected "the Expected Earnings and Risk Premium models in light of their complexities  
22 and potential inaccuracies," and instead opted to employ a methodology that utilizes the DCF and  
23 CAPM approaches, eliminates the outliers, and then averages the high and the low values to establish  
24 endpoints.<sup>217</sup> RUCO therefore contends that SWG's proposed COE is overstated and flawed because

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25  
26 <sup>212</sup> Exh. RUCO-24 at 3.

27 <sup>213</sup> *Id.* at 2-3.

28 <sup>214</sup> *Id.* at 4.

<sup>215</sup> RUCO Cl. Br. at 15.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.* at 16 (citing FERC Opinion No. 569 at 22, p. 31).

1 it relies on inaccurate EEM and RPM model results.<sup>218</sup>

2 Staff

3 Staff's expert witness, Mr. David C. Parcell, employed the Constant Growth DCF, CAPM,  
4 RPM, and CE methodologies to estimate an appropriate COE for SWG using a proxy group of nine  
5 publicly traded natural gas distribution utilities. Based on his COE analyses, Mr. Parcell concluded  
6 that SWG's COE falls within a range of 9.1 to 9.5 percent, and he recommended a rate of 9.3 percent,  
7 the midpoint of that range.<sup>219</sup>

8 Mr. Parcell's DCF model assumes that dividends are expected to grow at a constant rate. Mr.  
9 Parcell developed his dividend growth component by utilizing five different growth indicators: five  
10 year earnings retention, or fundamental growth; average historic growth in earnings per share ("EPS"),  
11 dividends per share ("DPS"), and book value per share ("BVPS"); 2016-2018 and 2022-2024  
12 projections of EPS, DPS, and BVPS; and five-year projections of EPS growth. As a result of his  
13 analysis, Mr. Parcell concluded the DCF cost of equity for SWG is between 8.6 and 9.6 percent, with  
14 a midpoint of 9.1 percent.<sup>220</sup>

15 Mr. Parcell criticized Mr. Hevert's DCF analysis for relying on metrics that inflated the COE  
16 range. According to Mr. Parcell, Mr. Hevert's DCF analysis only considers the highest growth rates  
17 for each proxy utility, which overstates the results of his analysis.<sup>221</sup> Further, Mr. Parcell claims that  
18 Mr. Hevert's analysis is improper because it relies primarily on EPS forecasts, which has been shown  
19 over recent years to be incapable of accurately predicting reliable EPS levels.<sup>222</sup>

20 Mr. Parcell explained that the CAPM is designed to describe and measure the relationship  
21 between a security's investment risk and its market rate of return. Mr. Parcell's CAPM analysis  
22 resulted in a COE range of 5.9 and 6.0 percent, with a midpoint of 5.95 percent. Mr. Parcell disagrees  
23 with Mr. Hevert's use of projected interest rates as part of his CAPM components. According to Mr.  
24 Parcell, prospective interest rates are not measurable and not achievable. Mr. Parcell also disagrees  
25 with Mr. Hevert's use of projected 30-year U.S. Treasury Bonds because the interest rates greatly

26 <sup>218</sup> RUCO Cl. Br. at 17-18.

27 <sup>219</sup> Tr. Vol. III at 401:8-22.

28 <sup>220</sup> Exh. S-5 at 22.

<sup>221</sup> Staff Cl. Br. at 21; Exh. S-5 at 24.

<sup>222</sup> Exh. S-5 at 24.



1 exceed the current level of long-term bonds which results in an overstated cost of capital.<sup>223</sup>

2 Mr. Parcell described the CE method as based on the economic concept of opportunity costs,  
3 which is the prospective return available to investors from alternative investments of similar risk. Mr.  
4 Parcell examined the ROEs for his group of proxy utilities, as well as unregulated companies, and  
5 investor acceptance of those returns by reference to the resulting market-to-book ratios. Mr. Parcell's  
6 CE analysis shows ROEs in the range of 9.0 to 10.0 percent, with a midpoint of 9.5 percent. Mr. Parcell  
7 criticizes Mr. Hevert's CE analysis for only examining projected ROEs for his proxy group, and  
8 ignoring the current and most recent business cycles.<sup>224</sup>

9 Mr. Parcell's RPM analysis focuses on the most recent five-year period of authorized ROEs  
10 and triple-B utility bond yields. Based on his analysis, Mr. Parcell determined that a reasonable current  
11 risk premium-derived ROE is in the range of 8.75 and 9.0 percent, with a midpoint of 8.9 percent. Mr.  
12 Parcell claims that Mr. Hevert's RPM analysis is flawed because it considers authorized ROEs of  
13 natural gas utilities dating back to 1980 through the lens of a regression analysis. According to Mr.  
14 Parcell, Mr. Hevert's regression analysis fails to capture the current relationship between authorized  
15 ROEs and interest rates, resulting in an ROE range that is not consistent with the recent level of  
16 authorized ROEs.<sup>225</sup>

17 Staff argues that the global COVID-19 pandemic has had an impact on market conditions.  
18 According to Staff, the cost of capital witnesses in this proceeding generally agree that the pandemic  
19 has had a significant negative impact on the market; however, those witnesses provide differing  
20 opinions as to whether market conditions attributable to the pandemic should be considered when  
21 setting rates in this proceeding. For example, Staff notes that RUCO's witness, Mr. Cassidy, testified  
22 that interest rates have generally been declining since December 2018, and those rates have recently  
23 fallen "precipitously" as a result of the pandemic which should be considered in setting the COE.<sup>226</sup>  
24 Staff also notes the testimony of SWG's witness, Mr. Hevert, who acknowledged that although the  
25 pandemic has increased risk, the increase in risk should not result in an increased return due to market

26  
27 <sup>223</sup> Exh. S-5 at 28-32.

<sup>224</sup> *Id.* at 32-37.

<sup>225</sup> *Id.* at 37-40.

<sup>226</sup> Staff Cl. Br. at 19 (*citing* Tr. Vol. III at 371-372).



1 volatility caused by the pandemic.<sup>227</sup>

2 Staff contends that the impact of the COVID-19 pandemic should not be considered as a factor  
3 in setting the COE in this case. Staff maintains that the impact of the market volatility and uncertainty  
4 since January of 2020, will remain unknown and cannot be viewed as representative of market  
5 conditions on a going forward basis. According to Staff, utilizing predicted future interest rates to  
6 determine COE is unsound and violates Arizona's historical test year regulatory paradigm.<sup>228</sup>

7 Resolution

8 In the *Bluefield* and *Hope* decisions, the United States Supreme Court established a  
9 "comparable earnings" standard to determine if state regulators are adopting a reasonable return for  
10 utility companies. In *Bluefield*, the Court held that:

11 A public utility is entitled to such rates as will permit it to earn a return on the  
12 value of the property which it employs for the convenience of the public equal  
13 to that generally being made at the same time and in the same general part of the  
14 county on investments on other business undertakings which are attended by  
15 corresponding risks and uncertainties.... The return should be reasonably  
16 sufficient to assure confidence in the financial soundness of the utility and  
17 should be adequate, under efficient and economical management, to maintain  
and support its credit and enable it to raise money necessary for the proper  
discharge of its public duties. A rate of return may be reasonable at one time  
and become too high or too low by changes affecting opportunities for  
investment, the money market, and business conditions generally.<sup>229</sup>

18 The Court found that "[r]ates which are not sufficient to yield a reasonable return on the value of the  
19 property used at the time it is being used to render the service are unjust, unreasonable and confiscatory,  
20 and their enforcement deprives the public utility company of its property in violation of the Fourteenth  
21 Amendment."<sup>230</sup>

22 In *Hope*, the Court found that:

23 [T]he return to the equity owner should be commensurate with returns on  
24 investments in other enterprises having corresponding risks. That return,  
25 moreover, should be sufficient to assure confidence in the financial integrity of  
the enterprise, so as to maintain its credit and to attract capital.<sup>231</sup>

26 <sup>227</sup> Staff Cl. Br. at 19 (citing Tr. Vol. I at 80-81).

27 <sup>228</sup> *Id.* at 19-20.

<sup>229</sup> *Bluefield*, 262 U.S. at 692-93.

<sup>230</sup> *Id.* at 690.

28 <sup>231</sup> *Hope*, 320 U.S. at 603.

1 The *Bluefield* and *Hope* decisions provide that the Commission must determine a return that is  
 2 equivalent to an investment with similar risk made at generally the same time, and should be sufficient  
 3 under efficient management to enable the utility to discharge its duties. The Court in *Bluefield* also  
 4 held, “[w]hat annual rate will constitute just compensation depends on many circumstances and must  
 5 be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts.”<sup>232</sup>

6 The parties presenting evidence on COE utilized similar methodologies of using a proxy group  
 7 of publicly traded utilities and cost of capital models to estimate the appropriate return on equity for  
 8 SWG. The parties presented evidence for COE that ranged from 5.90 to 10.75 percent, before making  
 9 adjustments based on risk, low CAPM model results, and/or economic conditions. After making the  
 10 adjustments, the parties’ recommended COE ranged from 7.60 to 10.75 percent.

11 Based on all of the evidence presented, we find that a COE of 9.10 percent will provide SWG  
 12 with a reasonable and appropriate return on its investment, maintain the overall financial integrity of  
 13 SWG, and will result in just and reasonable rates. The COE adopted herein reflects a downward  
 14 adjustment of 20 basis points to recognize the reduced risk associated with allowing a return on the  
 15 FVI, as discussed below.<sup>233</sup>

#### 16 **D. Return on the Fair Value Increment**

17 SWG proposed a 0.66 percent return on the FVI. Arizona Grain, RUCO, and Staff recommend  
 18 a 0.00 percent return on the FVI. However, in the event that the Commission determines that there  
 19 should be a specific return (greater than zero) applied to the FVI, Arizona Grain, RUCO, and Staff  
 20 recommend returns of 0.10 percent, 0.18 percent, and 0.30 percent, respectively.

#### 21 SWG

22 SWG proposed a return of 0.66 on the FVI, which is based on one-half of the Company’s  
 23 calculated real risk-free rate (net of inflation) 1.32 percent.<sup>234</sup> SWG submits that applying the risk-free  
 24 rate to determine the return on the FVI is consistent with the methodology utilized by the Commission  
 25

26  
 27 <sup>232</sup> *Bluefield*, 262 U.S. at 692.

28 <sup>233</sup> See Section VI.D., *infra*. We note that we decline to adopt the adjustment proposed by Arizona Grain and RUCO to reduce ROE based on the continuation of the decoupling mechanism.

<sup>234</sup> Half of the real risk-free rate of return of 1.32 percent equals 0.66 percent. SWG Cl. Br. at 40; Exh. SWG-7 at 51-52.

1 in SWG's last three rate cases.<sup>235</sup> SWG states that "[t]he Commission is required [under Arizona law]  
2 to determine fair value in setting rates and...the Commission must use that fair value determination to  
3 set the utility's rate base."<sup>236</sup> According to SWG, applying a return on the FVI satisfies the  
4 Commission's fair value finding requirement under the law.

5 SWG estimated the nominal long-term risk-free rate by averaging both the short-term projected  
6 yield of 30-year U.S. Treasury bonds of 3.25 percent, and the long-term projected yield of 30-year U.S.  
7 Treasury bonds of 4.05 percent, which averaged 3.65 percent.<sup>237</sup> SWG then applied an estimated long-  
8 term inflation rate of 2.30 percent, and calculated a real risk-free rate of 1.32 percent.<sup>238</sup> SWG argues  
9 that its proposed return on the FVI of 0.66 percent is comparable to the returns recently approved by  
10 the Commission for Arizona Public Service Company,<sup>239</sup> SWG,<sup>240</sup> and Tucson Electric Power  
11 Company.<sup>241</sup>

12 SWG submits that RUCO and Staff's methodologies for calculating their real risk-free rates are  
13 inappropriate because they focus on near-term forecasts of the nominal 30-year U.S. Treasury yield.  
14 SWG contends that reliance on the near-term forecasts captures a historically low real risk-free rate of  
15 return that reflects the uncertainty surrounding the COVID-19 pandemic.<sup>242</sup>

16 SWG contends that Arizona Grain's calculated risk-free rate of return is also inappropriate  
17 because Arizona Grain relied on the average daily 30-year U.S. Treasury yield during for December of  
18 2019, through January of 2020. SWG argues that since COE is forward looking, the estimated real  
19 risk-free rate of return on the FVI must be calculated by using projected yields, which Arizona Grain  
20

21 <sup>235</sup> SWG notes that Decision No. 70665 (December 24, 2008) was the first time in which the Commission authorized a  
return on SWG's FVI.

22 <sup>236</sup> SWG Cl. Br. at 40. See Decision No. 70665 at 31-32 (December 24, 2008 (Commission concluded that "[a]lthough we  
agree with Staff that it should not be necessary to provide [SWG] with any additional return on the increment between  
23 OCRB and FVRB, because that increment is not financed with investor-supplied funds, we find that applying a 1.00 percent  
return on the fair value increment is appropriate under the facts of this case and properly accounts for the effect of  
inflation"); Decision No. 72723 (January 6, 2012) (Commission approved a rate case settlement agreement); and Decision  
24 No. 76069 (April 11, 2017) (Commission approved a rate case settlement agreement).

25 <sup>237</sup> Exh. SWG-7 at 52.

26 <sup>238</sup> *Id.*

27 <sup>239</sup> See Decision No. 76295 at 22 (August 18, 2017) (the Commission approved a settlement agreement adopting a return  
on the FVI of 0.80 percent).

28 <sup>240</sup> See Decision No. 76069 at 7 (April 11, 2017) (the Commission approved a settlement agreement adopting a return on  
the FVI of 0.93 percent).

<sup>241</sup> See Decision No. 75975 at (February 24, 2017) (the Commission approved a settlement agreement adopting a return on  
the FVI of 1.00 percent).

<sup>242</sup> SWG Cl. Br. at 41.

1 failed to do.<sup>243</sup>

2 SWG asserts that the parties' recommendations to apply a 0.00 percent rate of return on the FVI  
3 would impact the financial profile and credit ratings of SWG. According to SWG, consistency and  
4 predictability are important facts considered by ratings agencies, as well as investors. SWG argues that  
5 failure to recognize a return on the FVI in this case would constitute an adverse change to the  
6 established practice of the Commission. To that end, SWG claims that any such adverse change in  
7 Commission practice "might affect the perception of the level of regulatory risk in Arizona relative to  
8 the returns provided and, by extension, the resulting impact on the long-run average cost of capital paid  
9 by [SWG's] customers."<sup>244</sup>

10 Arizona Grain

11 Arizona Grain argues that the Commission should adopt a 0.00 percent return on the FVI. In  
12 the alternative, Arizona Grain proposed a return on the FVI of 0.10 percent, which is based on one-half  
13 of Arizona Grain's calculated real risk-free rate (net of inflation) of 0.20 percent. Arizona Grain's real  
14 risk-free rate was calculated by taking the average daily 30-year U.S. Treasury yield for December  
15 2019 through January 2020 (2.30 percent), less the consumer price index ("CPI") rate of inflation over  
16 the past twelve months (2.10 percent).<sup>245</sup>

17 RUCO

18 RUCO also maintains that the Commission should adopt a 0.00 percent rate of return on the  
19 FVI. RUCO generally argues that the FVI provides utilities with a premium return above the ROE  
20 applied to OCRB. According to RUCO, the FVI does not represent investor-supplied funds; rather,  
21 the amount of the FVI is attributed to inflation. RUCO states that the Company's request for a return  
22 on the FVI is tantamount to "the Commission [ ] being asked to provide an unwarranted 'gift' to SWG  
23 through a return on the non-investor supplied fair value increment."<sup>246</sup> RUCO maintains that rejecting  
24 a return on non-investor supplied capital is consistent with sound regulatory policy.

25 RUCO contends that the Commission has discretion on whether to award a return on the FVI.

26  
27 <sup>243</sup> SWG Cl. Br. at 41.

<sup>244</sup> *Id.* at 42.

<sup>245</sup> AG Cl. Br. at 37.

<sup>246</sup> RUCO Cl. Br. at 20.

1 According to RUCO, a return on FVI is not mandated by Commission policy or Arizona case law.  
 2 Further, RUCO argues that there is no basis from a financial perspective to award a return on the FVI  
 3 since the investor did not supply the capital that resulted in the FVI. RUCO therefore proposes that a  
 4 zero percent return be applied to the FVI.<sup>247</sup>

5 In the alternative, RUCO proposed a return on the FVI of 0.18 percent, which is based on one-  
 6 half of RUCO's calculated real risk-free rate (net of inflation) of 0.36 percent. RUCO's real risk-free  
 7 rate was calculated by utilizing the forecasts of the 30-year U.S. Treasury yield for the fourth quarter  
 8 of 2020 (2.50 percent), less the CPI rate of inflation (2.14 percent) forecasted for the fourth quarter of  
 9 2020.<sup>248</sup>

10 Staff

11 Staff likewise recommends that the Commission adopt a 0.00 percent return on the FVI. Staff  
 12 argues that, from a financial perspective, it should not be necessary to provide for any return on the  
 13 FVI since that amount is not investor-supplied capital. As Mr. Parcell explained:

14  
 15 ...any value between zero percent and 0.6 percent could be used as the cost rate  
 16 on the FVI. As I stated above, is in addition to the return that the Company's  
 17 investors already earn on their investment in the Company. In this sense, an  
 18 above-zero cost rate for the FVI represents a bonus to the Company that would  
 19 have to find its justification in policy considerations instead of in pure economic  
 20 or financial principles; for that reason, the selection of an appropriate cost rate  
 21 within this range should fall to the Commission's discretion.<sup>249</sup>

22 In the alternative, Staff proposed a return on the FVI of 0.30 percent, which is based on one-  
 23 half of Staff's calculated real risk-free rate (net of inflation) of 0.60 percent. Staff computed a nominal  
 24 risk-free rate of 2.60 percent based on past, current, and forecasted yields for short-term and long-term  
 25 U.S. Treasury bonds. Staff's real risk-free rate was calculated by taking the nominal risk-free rate (2.60  
 26 percent), less the CPI rate of inflation (2.00 percent).<sup>250</sup>

27 <sup>247</sup> RUCO Cl. Br. at 19-20.

28 <sup>248</sup> Exh. RUCO-23 at 58-59.

<sup>249</sup> Exh. S-5 at 50-51.

<sup>250</sup> *Id.* at 48-51.



1        Resolution

2        Based on the record in this proceeding, we find that RUCO's alternative real risk-free rate of  
3 return on the FVI strikes an appropriate balance between capturing the current and expected economic  
4 environment and capital market conditions associated with the COVID-19 pandemic and forecasting  
5 an appropriate real risk-free rate. Although we agree with Arizona Grain, RUCO, and Staff that it is  
6 not necessary to provide the Company with any additional return on the increment between OCRB and  
7 FVRB because that increment is not financed with investor-supplied funds represented on its balance  
8 sheet, we find that applying a return on the FVI is appropriate under the specific facts and circumstances  
9 of this case. We further find that applying a 0.18 percent real risk-free rate to the FVI complies with  
10 the Commission's constitutional fair value requirement, is an appropriate methodology to determine  
11 the fair value rate of return without overstating the effects of inflation, and will result in just and  
12 reasonable rates.

13        In addition, we find that the application of a return on the FVI reduces risk to the Company  
14 because that return provides SWG with an additional source of income and cash flow.<sup>251</sup> Accordingly,  
15 we find that it is reasonable and appropriate under the circumstances to adjust the Company's COE  
16 downward by 20 basis points to reflect that reduced risk to SWG.

17                **E.      Fair Value Rate of Return**

18        Based on the foregoing, we find that a FVROR based upon the WACC derived by utilizing a  
19 return on the FVI of 0.18, a return on equity of 9.10 percent, and an embedded long-term cost of debt  
20 of 4.86 percent, complies with the constitutional fair value requirement, is an appropriate methodology  
21 to determine the fair value rate of return, and will result in just and reasonable rates. Using the capital  
22 structure adopted herein, we reach a WACC and overall FVROR of 5.36 percent for SWG.

23        ...

24        ...

25        ...

26        ...

27 \_\_\_\_\_  
28 <sup>251</sup> See Tr. Vol. I at 173:12-175:5 (Mr. Hevert testified that a return on FVI represents an additional source of income and cash flow which, *ceteris paribus*, reduces risk).



	<u>Capital Ratio</u>	<u>Capital Cost</u>	<u>FVRB Weighted Capital Cost</u>
Common Equity	38.66%	9.10%	3.52%
Long-Term Debt	36.99%	4.86%	1.80%
FVRB Increment Above OCRB	<u>24.35%</u>	0.18%	<u>0.04%</u>
Total	100%		5.36%

## **VII. Revenue Requirement**

Based on our findings herein, we determine the gross revenue for SWG should increase by \$36,798,901, or 7.10 percent, from \$518,218,363 in the test year to \$555,071,264.

Fair Value Rate Base	\$2,551,897,039
Adjusted Test Year Operating Income (Loss)	\$109,181,801
Required Fair Value Rate of Return	5.36%
Required Operating Income	\$136,775,458
Operating Income Deficiency	\$27,593,657
Gross Revenue Conversion Factor	1.3336
Gross Revenue Increase	\$36,798,901
Adjusted Test Year Revenue	\$518,218,363
Authorized Revenue Requirement	\$555,017,264
Revenue Increase (%)	7.10%

## **VIII. Rate Design Issues**

### **A. Cost of Service**

Once the required revenue level has been established, the next step in the ratemaking process is to determine the appropriate rates to be charged to each class of customers. The starting point in the rate design process is the class cost-of-service study ("CCOSS") which is designed to allocate the costs of providing service to customer classes. Other considerations are also taken into account in designing rates, including rate stability and continuity, and ease of administration.

As part of its amended application, SWG prepared a CCOSS with a twelve-month period ending January 31, 2019 as the test period, to perform jurisdictional allocations to separate the retail portion

of the Company's operations from the non-retail portion and to determine the overall revenue requirements and to further allocated costs among customer classes. No party disputes the Company's CCOSS. Staff recommends that SWG prepare and file another CCOSS as part of the Company's next general rate case. SWG does not oppose Staff's recommendation.

#### Resolution

We find that the Company's proposed CCOSS is reasonable and should be adopted for the purpose of setting rates in this proceeding. We further find that Staff's recommendation that SWG prepare and file another CCOSS as part of its next general rate case is appropriate and should be adopted.

### **B. Billing Determinants**

SWG's billing determinants were compiled by taking the monthly recorded number of bills and volumes by rate schedule for the TY, with the following adjustments to the recorded bills and volumes: 1) billing adjustments; 2) customer-specific volume annualizations; 3) customer reclassifications; 4) weather normalizations; and 5) customer annualizations. According to the Company, the methodology employed to develop the billing determinants in this case is the same methodology utilized in the Company's last four rate cases.<sup>252</sup> No party objected to or otherwise disputed the accuracy of the Company's billing determinants.

### **C. Rate Design**

SWG proposes to conceptually maintain its existing rate design. No party objected to the Company's proposed rate design. We find that the Company's proposed rate design is reasonable and appropriate and should therefore be adopted.

The parties' proposed revenue requirements, as well as the revenue requirement adopted in this Decision, would have the following bill impacts on a single-family residential customer with average annual usage of 24 therms:

...

...

---

<sup>252</sup> Exh. SWG-31 at 2-3.

	<u>Current Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Increase</u>
Company	\$36.16	\$42.39	\$6.23	17.23%
RUCO	\$36.16	\$39.51	\$3.35	9.26%
Staff	\$36.16	\$40.90	\$4.74	13.11%
Decision	\$36.16	\$39.66	\$3.50	9.68%

#### **D. DCA Mechanism**

The DCA is a full revenue decoupling rate design mechanism. The DCA provides the Company with an opportunity to recover the Commission-authorized revenue requirement when there is a reduction in use per customer and provides customers the benefit of a reduction in rates when the Company recovers more than the Commission-authorized revenue requirement.

#### SWG

SWG requests that the Commission continue the Company's DCA mechanism. According to SWG, the DCA is working as designed and is providing the benefits that were contemplated when revenue decoupling was adopted by the Commission, including providing the Commission greater control over the Company's revenue, preventing the Company from profiting from increased sales, enhancing focus on cost controls, and allowing the Company to partner with customers in promoting increased energy efficiency.<sup>253</sup>

In response to Arizona Grain's contention that the DCA has not incentivized reduced gas sales, SWG maintains that its robust energy efficiency programs have resulted in direct therm savings for the Company's customers. Specifically, SWG notes that its recent Annual Progress Report on Energy Efficiency and Renewable Energy<sup>254</sup> demonstrates that SWG has saved over 81 million therms over the lifetime of its energy efficiency program.<sup>255</sup> SWG also notes that total gas sales were 4.8 million therms lower in test year in this rate case than the test year in the Company's last rate case. According

<sup>253</sup> SWG Cl. Br. at 48.

<sup>254</sup> Exh. SWG-44.

<sup>255</sup> According to SWG, the reduction in usage resulted in a savings of \$139.2 million in avoided purchased gas costs and over a 4 million-ton reduction in carbon emissions. Exh. SWG-34 at 7-8.

1 to SWG, total gas sales decreased despite the fact that the Company's customer base increased by  
2 approximately 50,000 over that same timeframe.<sup>256</sup>

3 SWG contends that Arizona Grain's argument that per-customer decoupling provides a windfall  
4 to the Company is not supported by the evidence. SWG claims that for the roughly 50,000 new single-  
5 family residential customers added onto the system since the last rate case, the Company only recovered  
6 approximately \$11.43 in incremental annual revenue per new single-family residential customer. SWG  
7 states that by comparison, the Commission-authorized annual margin per customer for single-family  
8 residential customers is \$350.77. According to SWG, the large under-recovery of annual revenue per  
9 new customer demonstrates that per-customer decoupling neither provides a windfall nor guarantees a  
10 profit for SWG.<sup>257</sup>

11 Arizona Grain

12 Arizona Grain recommends that the Commission discontinue the Company's DCA mechanism.  
13 According to Arizona Grain, revenue decoupling deviates significantly from the traditional purpose of  
14 utility regulation. Arizona Grain states that under traditional ratemaking, regulators determine and set  
15 the price consumers will pay for service based on an estimate of the utility's costs and the amount of  
16 service the utility will sell to customers. Arizona Grain further states that under revenue decoupling,  
17 the regulators determine and set the revenue the utility will receive rather than the price for service.  
18 Since revenue decoupling ensures a particular level of revenue for the utility, Arizona Grain argues  
19 that revenue decoupling focuses on the utility rather than the customer. As a result, Arizona Grain  
20 maintains that the Commission should not approve the continuation of the Company's DCA  
21 mechanism.<sup>258</sup>

22 Arizona Grain explains that the Company's DCA mechanism is a full sales decoupling  
23 mechanism applied on a per-customer basis for certain rate classes. Under this method of decoupling,  
24 Arizona Grain further explains that the utility's revenue from gas sales to the relevant customer classes  
25 are reconciled, but revenue from fixed charges (e.g. basic monthly service charges and meter charges)  
26

27 <sup>256</sup> SWG Cl. Br. at 49-50.

28 <sup>257</sup> SWG Cl. Br. at 50.

<sup>258</sup> AG Cl. Br. at 45-48.

1 will not be reconciled.<sup>259</sup>

2 Arizona Grain contends that the DCA mechanism guarantees that SWG will receive a certain  
3 amount of revenue per customer in the affected classes, which in turn reduces risk for the Company's  
4 investors. As a result, Arizona Grain proposed a 15-basis point reduction to the authorized return on  
5 equity in the event that the Commission approves the continuation of the DCA.<sup>260</sup>

6 RUCO

7 RUCO did not take a formal position with respect to the continuation of the DCA. However,  
8 RUCO proposed a 15-basis point reduction to the authorized return on equity in the event that the  
9 Commission approves the continuation of the DCA.<sup>261</sup>

10 Staff

11 Staff recommends the continuation of the Company's DCA mechanism. According to Staff,  
12 the DCA continues to incorporate the following features that were identified in the Company's last rate  
13 case:

- 14 • it prevents utility profit from increased sales;
- 15 • it ensures that customers pay no more than costs authorized by the Commission;
- 16 • it includes customer protection from high winter bills due to a severe weather event;
- 17 • it allows for both upward and downward rate adjustments;
- 18 • it addresses the long-term declining usage issue for SWG; and
- 19 • it retains immediate permanent customer savings on commodity costs.<sup>262</sup>

20 Staff notes that SWG is not proposing an increase in basic monthly service fees, or otherwise  
21 advocating for more radical rate design changes. Staff does not favor "an extreme rate design change  
22 at this time" and claims that continuing the DCA represents a reasonable approach for addressing the  
23 stability of SWG's revenue stream.<sup>263</sup>

24 Resolution

25 We find that the continuation of the DCA mechanism is appropriate at this time. As noted by

26 <sup>259</sup> *Id.* at 50.

27 <sup>260</sup> See Section VIII.D., *supra*.

28 <sup>261</sup> See Section VIII.D., *supra*.

<sup>262</sup> Decision No. 72723 at 21.

<sup>263</sup> Staff Cl. Br. at 30.

1 the Company, the DCA mechanism has been functioning as expected and the benefits associated with  
2 the DCA mechanism identified in the Company's last rate case remain valid in this case. Accordingly,  
3 we adopt and approve the continuation of the DCA mechanism.

4 **E. Rate Phase-In**

5 In its Closing Brief, Arizona Grain contends, for the first time in this proceeding, that the rates  
6 approved in this proceeding be phased-in "over four or five years, without a return on the investment  
7 not fully recovered." According to Arizona Grain, a rate phase-in would protect customers from rate  
8 shock on top of the shocks already caused by the COVID-19 pandemic.<sup>264</sup>

9 SWG argues that Arizona Grain's proposed phase-in is unsubstantiated by the record and notes  
10 that no other party has made a similar recommendation. SWG contends that adopting the proposed  
11 phase-in "would breach the regulatory compact by clearly denying the Company a reasonable  
12 opportunity to earn its Commission authorized rate of return." Further, the Company states that the  
13 proposed phase-in would expand and compound the problem of regulatory lag. According to SWG,  
14 the proposed phase-in is unnecessary because the Company's proposed rate design and DCA make its  
15 bills affordable to customers, and notes that the average monthly residential customer bill will remain  
16 under \$40.00 even if the Commission grants the Company's proposed rate increase in its entirety.<sup>265</sup>

17 Resolution

18 We decline to adopt Arizona Grain's proposal for a rate phase-in for several reasons. First,  
19 since Arizona Grain is raising the issue of a rate phase-in for the first time in its Closing Brief, the  
20 evidentiary record does not support a rate phase-in. Second, unless SWG agrees to forego the recovery  
21 of the revenue deficiency (plus carrying costs) associated with a phase-in, the overall rate increase will  
22 be higher at the end of the phase-in than would otherwise occur in the absence of a phase-in.  
23 Accordingly, we deny Arizona Grain's request for a rate phase-in.

24 **IX. Miscellaneous Contested Issues**

25 **A. Excess Accumulated Deferred Income Taxes Expense Adjustment**

26 On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA,  
27

28 <sup>264</sup> AG Cl. Br. at 71-72.

<sup>265</sup> SWG Reply Br. at 47.



1 among other things, reduced the federal corporate income tax rates from 35 percent to a flat rate of 21  
 2 percent, effective January 1, 2018. The effect of the TCJA for most utilities in Arizona was twofold.  
 3 First, the reduction in federal corporate income tax triggered a decrease in the income tax obligations  
 4 compared to the Commission-authorized amounts, which resulted in income tax savings to most  
 5 utilities. Second, the tax reduction necessitated a restatement of the balance of accumulated deferred  
 6 income tax ("ADIT") at the lower tax rate, creating excess accumulated deferred income taxes  
 7 ("EADIT").

8 EADIT represents the portion of deferred tax liability that existed at the end of 2017 (calculated  
 9 at the 35 percent federal corporate income tax rate) that will no longer be paid to the federal government  
 10 as a result of the reduction of the income tax rate to 21 percent. EADIT consists of two components:  
 11 protected (plant-related) EADIT; and unprotected (non-plant) EADIT. The fundamental distinction  
 12 between both classifications of EADIT is that protected EADIT is subject to the IRS normalization  
 13 rules and violation penalties,<sup>266</sup> whereas unprotected EADIT is not.<sup>267</sup> Since unprotected EADIT is not  
 14 subject to the IRS normalization rules, the basis for amortizing unprotected EADIT is within the  
 15 discretion of the Commission.<sup>268</sup>

16 In Decision Nos. 76595 (February 26, 2018) and 76619 (March 29, 2018), the Commission  
 17 required that all Class A, B, and C utilities apply regulatory treatment to account for the impact of the  
 18 TCJA, and either: 1) apply for a tax expense adjustor mechanism within 60 days; 2) file an intent to  
 19 file a rate case within 90 days; or 3) file any other such application to address the ratemaking  
 20 implications of the TCJA within 60 days. SWG elected to proceed under the third option.<sup>269</sup>

21 On August 15, 2018, the Commission issued Decision No. 76798 (August 15, 2018), ordering  
 22 SWG to, among other things: 1) refund approximately \$20 million in annual income tax savings to  
 23 ratepayers resulting from the change in revenue requirement;<sup>270</sup> and 2) address the impact of the TCJA  
 24

25 <sup>266</sup> The TCJA penalizes a utility that returns protected EADIT to customers more rapidly than the IRS normalization rules  
 26 otherwise allow. In this case, the IRS normalization rules require SWG to return protected EADIT over an approximate  
 40-year period (the book life of the underlying property). Exh. SWG-11 at 4.

<sup>267</sup> Exh. SWG-11 at 3.

<sup>268</sup> Exh. S-1 at 4.

<sup>269</sup> On April 2, 2018, in Docket No. G-01551A-18-0080, SWG filed an application to establish a tax refund process in  
 28 compliance with the third option. See Decision No. 76798 (August 15, 2018).

<sup>270</sup> SWG has refunded the annual tax savings resulting from the TCJA to its customers. Tr. Vol VI at 906:3-908:7.

1 on the amortization of EADIT no later than 180 days, or as part of the Company's next rate case,  
 2 whichever occurred sooner.<sup>271</sup> On March 18, 2019, in compliance with Decision No. 76798,<sup>272</sup> SWG  
 3 opened this docket for the purpose of processing the Company's rate application and addressing the  
 4 amortization of EADIT.

5 SWG, RUCO, and Staff are in general agreement regarding the amortization of EADIT,  
 6 including the amount of the EADIT regulatory liability balance, the amortization period, and the  
 7 method of amortization. The only issue remaining in dispute is whether the Commission should apply  
 8 a carrying cost on the entire EADIT balance.

### 9 1. EADIT Balance and Amortization Adjustment

10 In its amended application, SWG determined its entire EADIT regulatory liability balance to  
 11 be approximately \$191 million. SWG further proposed to amortize its unprotected EADIT over the  
 12 same period as its protected EADIT, or 40 years.

#### 13 SWG, RUCO, and Staff<sup>273</sup>

14 SWG, RUCO, and Staff are in agreement that: the total amount of the Company's EADIT  
 15 (protected and unprotected) regulatory liability balance is approximately \$191 million, roughly \$37  
 16 million of which is unprotected EADIT;<sup>274</sup> and unprotected EADIT should be subject to a ten-year  
 17 straight-line amortization period.<sup>275</sup>

#### 18 Resolution

19 As agreed upon by the parties, and for the purpose of this proceeding, we find that the  
 20 Company's total EADIT regulatory liability balance is \$191 million, and it is reasonable that all  
 21 unprotected EADIT should be subject to a ten-year straight-line amortization period.<sup>276</sup>

22 ...

23 ...

25 <sup>271</sup> Tr. Vol. VI at 904:15-906:8.

26 <sup>272</sup> Staff acknowledged that the Company is in compliance with Decision No. 76798. Exh. S-1 at 7-8; Tr. Vol. V at 863:7-9.

27 <sup>273</sup> Arizona Grain took no position with respect to the EADIT balance.

<sup>274</sup> SW-1 at 9, 13.

<sup>275</sup> Staff Cl. Br. at 23.

28 <sup>276</sup> No party objected to the agreed upon EADIT balance or manner in which unprotected EADIT should be amortized.

## 2. Carrying Cost on EADIT

### SWG

SWG argues that the application of a carrying cost on the Company's EADIT balance is inappropriate because SWG was never ordered by the Commission to accrue a carrying cost on the EADIT balance. To that end, SWG asserts that Staff's reliance on Decision No. 76798 to claim that the Company was required to apply a carrying cost to EADIT is misplaced. Specifically, SWG maintains that none of the ordering paragraphs in Decision No. 76798 contain any reference to a regulatory liability account or a directive to accumulate interest of 5.2 percent.<sup>277</sup>

Further, SWG argues that Staff's reliance on the Commission's recent decisions regarding EADIT for Tucson Electric Power Company,<sup>278</sup> UNS Gas, Inc.,<sup>279</sup> and UNS Electric, Inc.<sup>280</sup> (collectively, the "UNSE Decisions") is also misplaced. According to SWG, the UNSE Decisions differ from Decision No. 76798 in two respects. First, SWG notes that the UNSE Decisions explicitly contain ordering paragraphs requiring the establishment of a regulatory liability and the accrual of interest to account for the deferral of refunds, whereas Decision No. 76798 does not. Second, SWG notes that the UNSE Decisions only required a carrying cost on amounts that those utilities were ordered to refund, but elected to defer. SWG asserts that the ordering paragraphs in Decision No. 76798 did not reference a carrying cost because the Company agreed to immediately refund the \$20 million in tax savings to ratepayers resulting from the change in revenue requirement, rather than defer that amount.<sup>281</sup>

Likewise, SWG argues that Staff's reliance on the Commission's recent decision regarding EADIT for Liberty Utilities (Black Mountain Sewer) Corp.<sup>282</sup> ("Liberty Decision") is likewise misplaced. First, SWG submits that the Liberty Decision is distinguishable from Decision No. 76798 because the utility in the Liberty Decision requested to have a carrying cost on its deferred regulatory liability account, unlike SWG. Further, SWG notes that the utility in the Liberty Decision increased

<sup>277</sup> SWG Cl. Br. at 24-25.

<sup>278</sup> See Decision No. 76692 (May 22, 2018).

<sup>279</sup> See Decision No. 76721 (May 22, 2018).

<sup>280</sup> See Decision No. 76720 (May 22, 2018).

<sup>281</sup> SWG Cl. Br. at 25-26.

<sup>282</sup> Decision No. 76804 (August 15, 2018).

1 its rate base as a result of the application of the carrying cost, whereas SWG decreased its rate base as  
2 a result of the EADIT balance being accounted for in deferred taxes.<sup>283</sup>

3 SWG contends that the application of a carrying charge on the EADIT balance would  
4 effectively penalize SWG because customers are already receiving the benefit of a reduction to rate  
5 base as a result of the EADIT balance being accounted for in deferred taxes. Specifically, SWG states  
6 that “application of a carrying cost results in double-counting of the financial impact of the EADIT  
7 balance – once through the reduction in rate base that is used to construct rates (both in this case and  
8 in prior general rate cases) and then also through the proposed carrying [cost].”<sup>284</sup> According to SWG,  
9 the purpose of reducing rate base for the balance of the EADIT is to compensate customers for the time  
10 value of money related to the timing in refunding the EADIT, as required by the IRS normalization  
11 rules.

12 SWG further contends that Staff’s proposal to compute a carrying cost on the entire EADIT  
13 balance of \$191 million is not sound. According to SWG, the application of a carrying cost on the  
14 entire unamortized EADIT balance is unequitable because a majority the EADIT balance constitutes  
15 protected EADIT which must be amortized and refunded to customers over 40 years based on IRS  
16 normalization rules. Rather, SWG submits that if a carrying cost were to be applied, that cost should  
17 only be applied to the amount of EADIT that theoretically would have been amortized and refunded to  
18 customers since August 15, 2018. Based on the Company’s calculation, the carrying charge would  
19 only amount to \$1,140,519,<sup>285</sup> not the \$19.8 million recommended by Staff. However, SWG maintains  
20 that even the reduced carrying charge represents a double charge because the EADIT balance has been  
21 and continues to be a reduction in rate base, which benefits ratepayers.

22 Arizona Grain

23 Arizona Grain took no position with respect to the application of a carrying cost on the EADIT  
24 balance.

26  
27 <sup>283</sup> SWG Cl. Br. at 26.

28 <sup>284</sup> *Id.* at 28.

<sup>285</sup> The Company’s calculation assumes the stipulated 10-year amortization period for unprotected EADIT and a 5.2 percent carrying cost.

RUCO

RUCO argues that applying a carrying cost to the Company's entire EADIT balance is fair and equitable under the circumstances. RUCO submits that the UNSE Decisions directed the collections of carrying costs on deferred TCJA regulatory accounts. According to RUCO, the Company's EADIT balance represents a \$191 million interest free loan. RUCO acknowledges that the ordering paragraphs in Decision No. 76798 do not specifically direct the application of a 5.2 percent carrying cost on the EADIT balance; however, RUCO states that it would also not be unreasonable or arbitrary to interpret that Decision No. 76798 as requiring a 5.2 percent carrying cost to be applied to the entire EADIT balance. RUCO maintains that any refund of EADIT carrying costs should be refunded through the Tax Expense Adjustor Mechanism ("TEAM") and not through rates.<sup>286</sup>

Staff

Staff contends that Decision No. 76798 ordered SWG to apply a 5.2 percent carry cost (or interest) on the Company's entire EADIT regulatory liability balance. Based on Staff's calculation, the estimated amount of accrued interest on the entire EADIT balance is \$19,806,853 as of August 15, 2020.<sup>287</sup> Staff recommends that the accrued interest on the EADIT balance be refunded to ratepayers as a one-time bill credit, no later than 60 days.<sup>288</sup>

Staff further contends that several other factors also support Staff's recommendation to apply a carrying charge to the entire EADIT balance. According to Staff, the Commission has ordered other utilities to apply a carrying cost on their deferred regulatory liabilities related to the TCJA. Specifically, Staff refers to Decision No. 76804 (August 15, 2018) in which the Commission adopted Liberty Utilities (Black Mountain Sewer) Corp.'s ("Liberty Utilities") proposal to establish a regulatory liability account for EADIT, with a carrying cost at the weighted average cost of debt in Liberty Utilities' then-pending rate case. Additionally, Staff submits that there is a time value associated with the excess money that SWG's customers have paid in income taxes that the Company has retained since 2018. As a result, Staff argues that the accrued interest associated with the Company's retention

<sup>286</sup> RUCO Cl. Br. at 31-32.

<sup>287</sup> Staff's calculation is based on the period from August 15, 2018 (the effective date of Decision No. 76798) through August 15, 2020 (the estimated date of a Commission Decision in this case prior to the continuance of this matter due to the COVID-19 pandemic).

<sup>288</sup> Exh. S-1 at 13-14.



1 of the EADIT balance should be refunded to customers.

2 Resolution

3 We will adopt a 5.2 percent carrying cost (or interest) applied on the Company's EADIT  
4 regulatory liability flow back from August 2018 through December 2020 in an amount of \$1.542  
5 million. Furthermore, we adopt Staff's recommendation that the accrued interest on the EADIT  
6 balance be refunded to ratepayers as a one-time bill credit, no later than 60 days of this Decision.

7 **B. COYL Program and Associated Surcharge Mechanism**

8 **1. COYL Program**

9 A COYL is the customer-owned exterior gas service line that connects the meter (*i.e.* point of  
10 delivery) to the customer's premises. SWG is not required to inspect or otherwise maintain facilities  
11 beyond the point of delivery, and customers who own COYL are responsible for replacing and repairing  
12 those service lines. Since customers often do not inspect or otherwise maintain their COYL, SWG has  
13 expressed safety concerns regarding COYL.<sup>289</sup>

14 The COYL program was originally approved by the Commission in Decision No. 72723  
15 (January 6, 2012), with the goal of replacing all COYL within the Company's Arizona service territory.  
16 The program allowed SWG to perform leak surveys and provide customers the opportunity to have  
17 leaking COYL replaced with facilities owned and maintained by SWG. In Decision No. 74304  
18 (January 29, 2014), the Commission approved expanding the COYL program to allow the Company to  
19 replace COYL in conjunction with other pipe replacement activities, regardless of whether there were  
20 leaks in the COYL. In Decision No. 76069 (April 11, 2017), the Commission further expanded the  
21 COYL program to allow the Company to replace COYL even if there was no pipeline replacement  
22 activity otherwise occurring in the area.

23 Staff recommends the continuation of the COYL program to replace COYL in the Company's  
24 Arizona service territory. Staff further recommends that SWG appoint an Independent Monitor to  
25 oversee COYL program cost effectiveness, help assure fair bidding for work between SWG affiliates  
26 and non-affiliates, and assist in the development of a Plan of Administration. No party opposed Staff's

27 \_\_\_\_\_  
28 <sup>289</sup> SWG no longer installs COYL; instead, SWG installs customer meters at the building or structural wall of the customer's premises.



1 recommendation.

2 **2. COYL Surcharge Mechanism**

3 Although Arizona Grain does not oppose the continuation of the COYL program, Arizona Grain  
4 argues that the proposed surcharge methodology is unreasonable because the surcharge does not  
5 equitably distribute the cost of the COYL program among customer classes. According to Arizona  
6 Grain, nearly all COYL properties are residential and customers like Arizona Grain do not benefit from  
7 the program. Arizona Grain notes that the COYL surcharge is charged on a flat, per therm rate, and  
8 the Company collected approximately \$2.9 million in COYL revenue during the TY, of which  
9 approximately \$1.6 million (or 56 percent) is charged to residential customers and \$1.3 million (or 44  
10 percent) is charged to non-residential customers.<sup>290</sup> In order to shift more costs of the COYL program  
11 onto residential customers, Arizona Grain submitted its own surcharge methodology that would collect  
12 approximately 90 percent of COYL revenue from residential customers.<sup>291</sup>

13 SWG opposes Arizona Grain's proposal to modify the COYL surcharge methodology.  
14 According to SWG, the surcharge methodology has worked as intended by the parties (including Staff  
15 and RUCO) since the Company's last rate case. SWG contends that Arizona Grain's proposed  
16 surcharge methodology would be incompatible with the existing program cap limits and would shift  
17 additional costs to both single-family and multi-family residential customer classes.<sup>292</sup>

18 Resolution

19 We find that it is reasonable and appropriate to continue the COYL program and associated  
20 surcharge mechanism to replace COYLs in the Company's service territory. We further find that  
21 Staff's recommendation to appoint an Independent Monitor to oversee COYL program cost  
22 effectiveness, help assure fair bidding for work between SWG affiliates and non-affiliates, and assist  
23 in the development of a Plan of Administration is reasonable and appropriate and should therefore be  
24 adopted.

25 We decline to adopt Arizona Grain's proposed modifications to the COYL surcharge  
26

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27 <sup>290</sup> AG Cl. Br. at 58-60

28 <sup>291</sup> Exh. AG-4 at Exhibit SJR-15.

<sup>292</sup> SWG Cl. Br. at 51.

1 methodology for several reasons. First, we note that the COYL surcharge, including cap limits,  
2 continue functioning as intended by the parties to the Company's last rate case. Second, we do not  
3 believe it is appropriate to shift additional expenses on to residential customers at this time.

4 **C. VSP Program and Associated Surcharge Mechanism**

5 **1. VSP Program<sup>293</sup>**

6 SWG

7 SWG maintains that the VSP program was created in response to industry-wide concerns  
8 regarding aging natural gas infrastructure, including the VSP that was installed prior to 1970 when the  
9 federal pipeline safety code was first implemented. According to SWG, the purpose of the VSP  
10 program, namely to proactively replace vintage steel pipe on an accelerated basis, is the same now as  
11 it was when the program was approved by the Commission in 2016. SWG submits that there is a  
12 continuing health and safety benefit to enhancing the Company's system through accelerated VSP  
13 replacements.<sup>294</sup>

14 In response to the parties' opposition to the continuation of the VSP program, SWG asserts that  
15 there is no credible or compelling evidence showing that SWG has not effectively managed the program  
16 in accordance with the Commission-approved POA, nor shown that all of the potential safety concerns  
17 that caused the parties to recommend approval of the program in 2016, do not continue to exist today.  
18 As a result, SWG argues that the VSP program should be continued by the Commission.<sup>295</sup>

19 Arizona Grain

20 Arizona Grain asserts that the VSP program should be discontinued because the replacement  
21 of VSP is not needed for health and safety reasons. Arizona Grain maintains that SWG has replaced  
22 hundreds of millions of dollars of fully functioning, safely operating, and well-maintained older pipe  
23 with brand new pipe. According to Arizona Grain, the VSP program is extraordinarily expensive and  
24 the continuation of the program is not justified under the circumstances.<sup>296</sup>

26  
27 <sup>293</sup> See Section IV.B.1.f., *supra*, for a general description of the VSP program.

28 <sup>294</sup> SWG Cl. Br. at 54-58.

<sup>295</sup> SWG Cl. Br. at 58.

<sup>296</sup> AG Cl. Br. at 8-9.

1        RUCO

2        RUCO argues that the VSP program be discontinued because “there is little if any need for the  
3 accelerated replacement of VSP in SWG’s gas distribution system.” RUCO notes that gas leaks in  
4 distribution lines do occur and states that SWG needs to responsibly address any leaks on the system.  
5 However, RUCO maintains that SWG’s leak data does not indicate a systemic problem of leaks with  
6 steel pipe within the Company’s distribution system. According to RUCO, a special program targeting  
7 the replacement of all steel pipe based on age is not justified, and the Commission should therefore  
8 discontinue the VSP program.<sup>297</sup>

9        Staff

10       According to Staff, SWG should continue to replace VSP in situations where the replacement  
11 is warranted in the ordinary course of running its Arizona gas distribution utility system. However,  
12 Staff states that it does not believe there is adequate justification for continuing the accelerated VSP  
13 program and its associated surcharge mechanism. In support, Staff cites the testimony of its witness,  
14 Mr. Richard Kuprewicz, who concluded that the leak data provided by SWG does not support a VSP  
15 replacement program for the Company’s steel distribution pipe within Arizona. As a result, Staff  
16 contends that there is no evidence of concerns regarding public health and safety related to VSP  
17 replacement. Staff therefore recommends that the VSP surcharge be discontinued. Staff further  
18 recommends that SWG present a plan for accounting for and returning or recovering any remaining  
19 surcharge amounts associated with the VSP program.<sup>298</sup>

20                    **2.       VSP Surcharge Mechanism**

21       In the event that the Commission approves the continuation of the VSP program, Arizona Grain  
22 argues that the proposed VSP surcharge methodology is unreasonable because the surcharge does not  
23 equitably distribute the cost of the VSP program among customer classes. According to Arizona Grain,  
24 residential customers are the primary beneficiary of the VSP program. Arizona Grain notes that the  
25 VSP surcharge is charged on a flat, per therm rate, and the Company collected approximately \$2.0  
26 million in VSP revenue during the TY, of which approximately \$1.1 million (or 56 percent) is charged  
27

28       <sup>297</sup> RUCO Cl. Br. at 28-29.

<sup>298</sup> Staff Cl. Br. at 17; Exh. S-16 at 4-5.

1 to residential customers and \$0.9 million (or 44 percent) is charged to non-residential customers.<sup>299</sup> In  
 2 order to shift more costs of the VSP program onto residential customers, Arizona Grain submitted its  
 3 own surcharge methodology that would collect approximately 80 percent of VSP revenue from  
 4 residential customers.<sup>300</sup>

5 SWG opposes Arizona Grain's proposal to modify the VSP surcharge methodology. According  
 6 to SWG, the surcharge methodology has worked as intended by the parties (including Staff and RUCO)  
 7 since the Company's last rate case. SWG contends that Arizona Grain's proposed surcharge  
 8 methodology would be incompatible with the existing program cap limits and would shift additional  
 9 costs to both single-family and multi-family residential customer classes.<sup>301</sup>

#### 10 Resolution

11 We find that the VSP program should be discontinued at this time. We agree with the parties  
 12 that the evidence does not establish the existence of an immediate public health and safety concern  
 13 regarding the condition of the vintage steel pipe on the Company's system. To the extent that SWG  
 14 discovers future leaks on its system, we expect the Company to make the necessary repairs and  
 15 otherwise fulfill its obligation to provide safe and reliable service to customers without the VSP  
 16 program. Further, we believe it is reasonable and appropriate to adopt Staff's recommendation that  
 17 SWG present a plan for accounting for and returning or recovering any remaining surcharge amounts  
 18 associated with the VSP program. Since the VSP program has been discontinued, we need not address  
 19 Arizona Grain's arguments in support of modifying the VSP surcharge methodology.

#### 20 **D. 7000/8000 Driscopipe Program and Associated Surcharge Mechanism**

##### 21 SWG

22 SWG proposes to implement a program to fund the replacement of a series of polyethylene  
 23 plastic pipe (known as "7000/8000 Driscopipe") that was installed in the Company's Arizona system  
 24 prior to 2001, mainly during the mid-1980's and mid-1990's.<sup>302</sup> According to SWG, the Company has  
 25

26 <sup>299</sup> AG Cl. Br. at 60-62.

27 <sup>300</sup> Exh. AG-4 at Exhibit SJR-17.

28 <sup>301</sup> SWG Cl. Br. at 52.

<sup>302</sup> SWG reports that the Company's Arizona system contains approximately 10,800 miles of 7000/8000 Driscopipe. Exh. SWG-35 at 2-3.

1 identified potential safety and reliability concerns with the 7000/8000 Driscopipe, and has been  
2 monitoring and addressing those concerns through its Distribution Integrity Management Program  
3 (“DIMP”) since 2005. SWG notes that the Pipeline Hazardous Materials Safety Administration  
4 (“PHMSA”) has reported material degradation found on this type of pipe located in the southwest. As  
5 of March 2019, SWG reports that the Company has experienced 129 known leaks on the 7000/8000  
6 Driscopipe caused by material degradation.<sup>303</sup>

7 SWG claims that identifying material degradation to the 7000/8000 Driscopipe is difficult in  
8 the absence of a leak or when the pipe is exposed in the field for routine maintenance purposes. Under  
9 the proposed program, the Company states that it will proactively monitor and evaluate the 7000/8000  
10 Driscopipe through enhanced field inspections. According to the Company, the enhanced field  
11 inspections will allow SWG to collect a greater amount of data and information to more effectively  
12 assess its 7000/8000 Driscopipe inventory in Arizona.<sup>304</sup>

13 Arizona Grain

14 Arizona Grain opposes the approval of a surcharge to allow SWG to recover the costs associated  
15 with its proposed 7000/8000 Driscopipe program. According to Arizona Grain, the costs are a regular  
16 part of the Company’s operations and there is no reason to provide special treatment by creating a  
17 surcharge. Arizona Grain notes that SWG has known about the material degradation issues associated  
18 with this pipe for at least 15 years, and SWG has been monitoring, inspecting, and replacing the pipe  
19 for more than a decade without any type of special ratemaking mechanism. In the event that the  
20 Commission does authorize a surcharge, Arizona Grain maintains that the surcharge should be  
21 calculated fairly to recover the costs “from all customer classes (except G-30 and Special Contracts)  
22 on an equal-cents per therm basis.”<sup>305</sup>

23 Arizona Grain asserts that there is no sound public policy reason for the Commission to approve  
24 the program. Arizona Grain states that SWG has an obligation to ensure the safety and reliability of  
25 its service, and should take whatever actions are necessary to fulfill that obligation. According to  
26 Arizona Grain, there is no operational reason for the Commission to approve any particular type of

27 <sup>303</sup> SWG Cl. Br. at 58-63.

28 <sup>304</sup> *Id.*

<sup>305</sup> AG Cl. Br. at 62-63.



1 enhanced safety investigation or surveillance.<sup>306</sup>

2 Arizona Grain states that there are three important reasons why the Commission should not  
3 preapprove this type of safety related program: 1) natural gas utilities, not their regulators, have an  
4 obligation to comply with PHMSA DIMP requirements and to implement those plans; 2) approval of  
5 the program might impede the Company's ability to make changes to its safety programs based on  
6 newly discovered information because modifications to the program may require further Commission  
7 approval; and 3) SWG has not shown how the proposed program is different from any other safety  
8 program so as to warrant extraordinary treatment by the Commission.<sup>307</sup>

9 RUCO

10 RUCO argues that the proposed program should not be adopted because: 1) the Company's  
11 leak performance records do not support the accelerated replacement of the 7000/8000 Driscopipe; 2)  
12 the proposed program is proactive, rather than safety related; and 3) the proposed program does not  
13 legally qualify as an adjustor. According to RUCO, "[t]here is not one reason why the Commission  
14 should consider non-traditional, extraordinary ratemaking to approve costs associated with enhanced  
15 field inspections to find degraded pipe."<sup>308</sup>

16 Staff

17 Staff recommends that the Company's proposed 7000/8000 Driscopipe program be denied at  
18 this time. Based on Staff's engineering analysis, the Company's leak performance records do not  
19 support the accelerated replacement of the 7000/8000 Driscopipe in the Company's Arizona system.  
20 Further, Staff found no evidence of concerns regarding public health and safety related to the  
21 7000/8000 Driscopipe replacement. According to Staff, further investigation and technical study into  
22 the potential degradation issues associated with the 7000/8000 Driscopipe is needed before the  
23 Commission adopts such a program.<sup>309</sup>

24 Resolution

25 We find that the proposed 7000/8000 Driscopipe program should not be adopted at this time.

26  
27 <sup>306</sup> *Id.* at 68.

<sup>307</sup> *Id.* at 68-69.

<sup>308</sup> RUCO Cl. Br. at 29-30.

<sup>309</sup> Exh. S-16 at 5.



1 We agree with the parties that the evidence does not establish the existence of an immediate public  
2 health and safety concern regarding the condition of the 7000/8000 Driscopipe in the Company's  
3 system. Indeed, as noted by SWG, the Company has been monitoring and addressing the potential  
4 safety and reliability concerns since 2005. We further agree with Staff that further investigation and  
5 technical study into the potential degradation issues associated with the 7000/8000 Driscopipe is  
6 needed before the Commission adopts such a program. To the extent that SWG discovers material  
7 degradation to the 7000/8000 Driscopipe in its system, we expect the Company to make the necessary  
8 repairs and otherwise fulfill its obligation to provide safe and reliable service to customers without the  
9 proposed program.

10 **E. Renewable Natural Gas Program**

11 Renewable Natural Gas ("RNG") is pipeline-quality gas derived from the decomposition of  
12 organic waste material. Under the proposed RNG program, SWG seeks Commission approval to meet  
13 up to 1% of its forecasted annual Arizona retail sales with RNG purchases by 2025; 2% by 2030; and  
14 3% by 2035. Further, SWG seeks approval to include the cost of the RNG purchases in the Company's  
15 Purchased Gas Adjustment mechanism.<sup>310</sup>

16 SWG

17 SWG argues that the RNG program should be adopted because that there are potential  
18 environmental and financial benefits to ratepayers associated with the RNG program. SWG states that  
19 while the costs of RNG prices could fluctuate, the risks associated with price fluctuation could be  
20 mitigated by appropriate contracting. Further, SWG notes that all RNG purchases would be reviewed  
21 by the Commission and would be subject to a prudency review. According to the Company, Nevada  
22 and California have approved similar RNG programs for SWG. SWG notes that if the Commission  
23 determines that a workshop is needed to further explore the potential benefits of an RNG program, the  
24 Company is willing to participate.<sup>311</sup>

25 Arizona Grain

26 Arizona Grain opposes the proposed RNG program at the present time. According to Arizona  
27

28 <sup>310</sup> Exh. SWG-28 at 4.

<sup>311</sup> SWG Cl. Br. at 52-53; SWG Reply Br. at 48.

1 Grain, RNG development is still in its infancy and the cost of RNG is significantly more expensive  
2 than conventional natural gas. Arizona Grain contends that a program for RNG might be appropriate  
3 if the following scenarios are met: 1) if a market develops for RNG; 2) if RNG's environmental  
4 attributes can be certified (and potentially monetized); and 3) if the cost of RNG is in line with the cost  
5 of conventional natural gas. Arizona Grain claims that "we are a long way away from satisfying even  
6 one of [those] conditions, let alone all of them."<sup>312</sup>

7 RUCO

8 RUCO opposes the Company's proposal to incorporate RNG into its gas supply portfolio  
9 because there are too many unknown variables associated with RNG. RUCO maintains that the costs  
10 of such a program are currently unknown, and the benefits cannot be quantified. RUCO submits that  
11 absent a better understanding of the costs and benefits to ratepayers, the RNG program should be denied  
12 at this time. RUCO states that it is not opposed to the Commission holding a workshop to gain a better  
13 understanding of RNG.<sup>313</sup>

14 Staff

15 Staff recommends that the proposed RNG program be denied, and that SWG continue to  
16 address the acquisition and sale of RNG on a case-by-case basis through its Schedule No. G-65 Tariff.  
17 Staff states that it does not believe the RNG program is appropriate at this time due to the potential  
18 high and unknown costs of RNG.<sup>314</sup>

19 Resolution

20 We find that there are too many unknown variables associated with RNG to support the  
21 adoption of the proposed RNG program at this time. We note that the proposed RNG program involves  
22 a high-risk, speculative activity, and we do not believe it would be appropriate to pass the associated  
23 risks and costs on to ratepayers.

24 **F. Corporate Allocation Methodology**

25 RUCO recommends that the Commission schedule a workshop to address corporate cost  
26

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27 <sup>312</sup> AG Cl. Br. at 63-65.

28 <sup>313</sup> RUCO Cl. Br. at 30-31.

<sup>314</sup> Staff Cl. Br. at 28-29.

1 allocations. RUCO states that the Company does not follow National Association of Regulatory Utility  
2 Commissioners (“NARUC”) guidelines with respect to cost allocations. RUCO notes that NARUC  
3 recommends direct cost allocation, while the Company utilizes indirect cost allocation based on a four-  
4 factor methodology. According to RUCO, the Company’s methodology results in a significant amount  
5 of parent company allocated costs, unrelated to Arizona operations, that the Company seeks to recover  
6 from ratepayers.<sup>315</sup>

7 Resolution

8 We note that Staff and intervenors should propose adjustments whenever an inappropriate cost  
9 allocation is discovered. We further note that a formal Commission policy is not needed for parties to  
10 propose such adjustments. Although RUCO suggests that the Commission should open a generic  
11 workshop docket to address the general concept of corporate cost allocations, we are not convinced  
12 that the issues raised in this proceeding warrant that utilization of Staff resources.

13 **G. Pinal Energy Litigation**

14 RUCO states that it is concerned with the on-going costs associated with the litigation between  
15 Pinal Energy, LLC and SWG (“Pinal Energy Litigation”). RUCO states that it “is using the venue of  
16 this rate case to possibly defer any legal costs and to ensure the Commission and the Company are  
17 aware the RUCO will be monitoring these costs and taking whatever action is necessary to ensure the  
18 legal fees associated with the litigation are not recovered from ratepayers and refunded if it is  
19 determined the Company acted in bad faith.”<sup>316</sup>

20 Resolution

21 RUCO has not made any adjustment or provided any specific recommendation regarding Pinal  
22 Energy Litigation costs. Accordingly, we take no action with respect to the Pinal Energy Litigation at  
23 this time.

24 **X. Miscellaneous Uncontested Issues**

25 **A. Tax Expense Adjustor Mechanism**

26 Staff recommends that the Commission approve a Tax Expense Adjustor Mechanism  
27

28 <sup>315</sup> RUCO Cl. Br. at 32-34.

<sup>316</sup> RUCO Cl. Br. at 36.

1 (“TEAM”) related to the TCJA. According to Staff, the purpose of the TEAM is to allow SWG to  
 2 timely recognize any future changes in federal and state tax law.<sup>317</sup> SWG is in agreement with the  
 3 TEAM, as proposed by Staff.<sup>318</sup> No other party opposed the TEAM. We find that the TEAM, as  
 4 proposed by Staff, is reasonable and should therefore be adopted.

#### 5 **B. Miscellaneous Tariff Modifications**

6 In its amended application, SWG proposes various tariff changes to conform with current  
 7 business practices. With the exception of the proposed changes to Tariff Sheet No. 234, Rule 10,<sup>319</sup>  
 8 Staff is in agreement with the tariff changes proposed by the Company. No party opposed the  
 9 Company’s tariff revisions.

#### 10 **C. Arizona Price Stability Program**

11 The Arizona Price Stability Program (“APSP”) is a programmatic hedge that consists of fixed-  
 12 term firm gas supplies and first of the month-index price purchases coupled with fix-for-floating index  
 13 swaps. The purpose of these hedging strategies is to mitigate short-term market price volatility. SWG  
 14 currently caps the APSP at 25 percent of its forecasted annual average portfolio volume.<sup>320</sup>

15 SWG discussed terminating the APSP with Staff as part of this rate case proceeding. Staff  
 16 reviewed the Company’s proposal and concluded that the APSP provided only a marginal benefit in  
 17 terms of price volatility reduction (1.53 percent versus 2.18 percent without APSP) that was insufficient  
 18 to justify the program’s price premium. Therefore, Staff states that it is in agreement with the  
 19 Company’s decision to terminate the APSP.<sup>321</sup> No other party provided comments or objections with  
 20 respect to this issue.

#### 21 **D. Removal Cost Allocation Study**

22 In Decision No. 76069, the Commission adopted a rate case settlement agreement in which  
 23 SWG agreed to perform a removal cost allocation study to determine the validity of significant  
 24 increases in cost of removal charges recorded in the 2015 test year. Specifically, the removal costs for  
 25

26 <sup>317</sup> Staff Cl. Br. at 24.

27 <sup>318</sup> SWG Reply Br. at 24.

28 <sup>319</sup> The Company subsequently withdrew from consideration its proposed modifications to Tariff Sheet No. 234, Rule No. 10. Exh. SWG-16 at 14-15.

<sup>320</sup> Exh. S-18 at 4.

<sup>321</sup> Exh. S-18 at 4.

1 Accounts 376 and 380 were much higher in 2015 than in previous periods.<sup>322</sup>

2 In its amended application, SWG submitted the removal cost allocation study in compliance  
3 with Decision No. 76069. The study concludes that the charges made to accumulated depreciation are  
4 correct, and that the account balances for Accounts 376 and 380 are fairly stated.<sup>323</sup> No party objected  
5 to the Company's removal cost allocation study.

6 \* \* \* \* \*

7 Having considered the entire record herein and being fully advised in the premises, the  
8 Commission finds, concludes, and orders that:

9 **FINDINGS OF FACT**

10 1. SWG is a public service corporation engaged in furnishing gas utility service in Arizona  
11 pursuant to authority granted by the Commission.

12 2. On May 1, 2019, SWG filed an application for an increase in rates for utility service  
13 provided in Arizona, and for other regulatory approvals.

14 3. On May 31, 2019, the Commission's Utilities Division Staff ("Staff") filed a Letter of  
15 Sufficiency stating that SWG's application had met the sufficiency requirements outlined in Arizona  
16 Administrative Code ("A.A.C.") R14-2-103, and classifying the Company as a Class A utility.

17 4. Intervention in this matter was granted to RUCO, Richard Gayer, Arizona Grain,  
18 NatureSweet, and Bullhead City.

19 5. On October 24, 2019, SWG filed an amendment to its application to include additional  
20 PTYP.

21 6. The procedural history and positions of the parties as set forth in the Discussion portion  
22 of this Decision are accurate and are incorporated herein by reference as though set forth in full herein.

23 7. Notice of the amended application was provided in accordance with the law.

24 8. The hearing commenced as scheduled via videoconference on June 30, 2020, and  
25 continued for seven additional days, concluding on July 10, 2020.

26 9. Based on the record in this proceeding, the adjustments to rate base adopted herein are  
27

28 <sup>322</sup> Exh. SWG-10 at 4.

<sup>323</sup> *Id.* at Exhibit DAW-1.

just and reasonable and in the public interest, and result in an adjusted fair value rate base of \$2,551,897,039 for the purpose of establishing rates in this proceeding.

10. Based on the record in this proceeding, the adjustments to test year operating expense adopted herein are just and reasonable and in the public interest, and result in an adjusted test year operating expense of \$409,036,562 for the purpose of establishing rates in this proceeding.

11. Based on the record in this proceeding, it is reasonable and in the public interest to adopt the following capital structure and FVROR:

	<u>Capital Ratio</u>	<u>Capital Cost</u>	<u>FVRB Weighted Capital Cost</u>
Common Equity	38.66%	9.10%	3.52%
Long-Term Debt	36.99%	4.86%	1.80%
FVRB Increment Above OCRB	<u>24.35%</u>	0.18%	<u>0.04%</u>
Total	100%		5.36%

12. Based on the record in this proceeding, the following findings are just and reasonable and in the public interest for purposes of establishing rates for SWG:

Fair Value Rate Base	\$2,551,897,039
Adjusted Test Year Operating Income	\$109,181,801
Required Fair Value Rate of Return	5.36%
Required Operating Income	\$136,775,458
Operating Income Deficiency	\$27,593,657
Gross Revenue Conversion Factor	1.3336
Gross Revenue Increase	\$36,798,901
Test Year Revenue	\$518,218,363
Authorized Revenue Requirement	\$555,017,264
Revenue Increase	7.10%

13. Based on the record in this proceeding, the rate design proposed by the Company, as discussed herein, is in the public interest and will result in just and reasonable rates. The rates approved herein will increase the monthly bill of the typical single-family residential customer with average annual usage of 24 therms by \$3.50, from \$36.16 to \$39.66 (or 9.68 percent).



1           14.     Based on the record in this proceeding, it is reasonable and in the public interest to  
2 continue the Delivery Charge Adjustment Provision until further order of the Commission.

3           15.     Based on the record in this proceeding, the Company's EADIT regulatory balance is  
4 approximately \$191, roughly \$37 million of which is unprotected EADIT. It is just and reasonable and  
5 in the public interest to require the Company to amortize unprotected EADIT utilizing a 10-year  
6 straight-line amortization period.

7           16.     Based on the record in this proceeding, it is in the public interest to require the Company  
8 to apply a carrying cost on the EADIT balance.

9           17.     Based on the record in this proceeding, it is reasonable and in the public interest to  
10 continue the COYL program and associated surcharge mechanism. It is further reasonable and in the  
11 public interest to require the Company to appoint an Independent Monitor to oversee COYL program  
12 cost effectiveness, help assure fair bidding for work between SWG affiliates and non-affiliates, and  
13 assist in the development of a Plan of Administration.

14          18.     Based on the record in this proceeding, it is reasonable and in the public interest to  
15 discontinue the VSP program and associated surcharge.

16          19.     Based on the record in this proceeding, it is not in the public interest to adopt the  
17 Company's proposed 7000/8000 Driscopipe replacement program.

18          20.     Based on the record in this proceeding, it is not in the public interest to adopt the  
19 Company's proposed RNG program.

20          21.     Based on the record in this proceeding, it is reasonable and appropriate to adopt the  
21 TEAM mechanism, as recommended by Staff.

22                   **CONCLUSIONS OF LAW**

23           1.     Southwest Gas Corporation is a public service corporation within the meaning of Article  
24 XV the Arizona Constitution, and A.R.S. Title 40, Chapter 2.

25           2.     The Commission has jurisdiction over Southwest Gas Corporation and the subject  
26 matter of the amended application.

27           3.     Notice of the amended application was provided in compliance with the law.  
28

4. For purposes of this proceeding, Southwest Gas Corporation's jurisdictional fair value rate base is determined to be \$2,551,897,039.

5. The rates, charges, and conditions of service authorized and established herein are just and reasonable and in the public interest.

## ORDER

IT IS THEREFORE ORDERED that Southwest Gas Corporation shall file with the Commission, on or before December 31, 2020, revised schedules of rates and charges consistent with the discussion herein.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after January 1, 2021.

IT IS FURTHER ORDERED that Southwest Gas Corporation shall notify its customers of the authorized rates and charges and their effective date, in a form acceptable to the Commission's Utilities Division, by means of an insert in its next regularly scheduled billing and by posting notice on its website in a prominent manner and conspicuous location.

IT IS FURTHER ORDERED that Southwest Gas Corporation shall file with Docket Control, as a compliance item in this docket, within 10 days after the date notice of the authorized rates and charges is sent to customers, a copy of the notice provided to customers.

IT IS FURTHER ORDERED that Southwest Gas Corporation is authorized to continue the Customer Owned Yard Line replacement program, as authorized under Decision Nos. 72723 (January 6, 2012) and 74304 (January 29, 2014) but not Decision No. 76069 (April 11, 2017), and the Customer Owned Yard Line replacement program surcharge mechanism authorized in this Decision, until further order by the Commission. Consistent with Decision Nos. 72723 and 74304, Southwest Gas Corporation shall not replace a Customer Owned Yard Line under this program unless the replacement is in conjunction with other pipe replacement activity otherwise occurring in the area or a leak survey showing a leak in the Customer Owned Yard Line.

IT IS FURTHER ORDERED that Southwest Gas Corporation shall work with the Commission's Utilities Division, and any party to this proceeding if they so desire, to develop a Plan

1 of Administration for the Customer Owned Yard Line replacement program that is consistent with this  
2 Decision.

3 IT IS FURTHER ORDERED that Southwest Gas Corporation shall appoint an Independent  
4 Monitor acceptable to Staff to oversee the Customer Owned Yard Line replacement program, for the  
5 reasons identified herein.

6 IT IS FURTHER ORDERED that Southwest Gas Corporation is authorized to continue the  
7 Delivery Charge Adjustment Provision until further order by the Commission.

8 IT IS FURTHER ORDERED that Southwest Gas Corporation is not authorized to continue the  
9 Vintage Steel Pipe replacement program, and that program and associated surcharge are hereby  
10 discontinued.

11 IT IS FURTHER ORDERED that Southwest Gas Corporation shall file with Docket Control,  
12 as a compliance item in this docket, no later than sixty (60) days from the effective date of this Decision,  
13 a plan for accounting for any remaining surcharge amounts associated with the Vintage Steel Pipe  
14 replacement program, as discussed herein.

15 IT IS FURTHER ORDERED that Southwest Gas Corporation is authorized to implement the  
16 Tax Expense Adjustor Mechanism, as recommended by Staff.

17 IT IS FURTHER ORDERED that Southwest Gas Corporation shall work with the  
18 Commission's Utilities Division, and any party to this proceeding if they so desire, to develop a Plan  
19 of Administration for the Tax Expense Adjustor Mechanism.

20 IT IS FURTHER ORDERED that Southwest Gas Corporation shall refund the accrued interest  
21 on the EADIT balance in the amount of \$1.542 million to ratepayers as a one-time bill credit, no later  
22 than 60 days of this Decision.

23 IT IS FURTHER ORDERED that Southwest Gas Corporation shall file an updated Class Cost  
24 of Service Study as part of its next general rate case.

25 IT IS FURTHER ORDERED that, prior to June 1, 2021, Staff shall open a generic docket and  
26 hold not less than one workshop to explore the role of renewable natural gas in Arizona. The docket  
27 shall be open to all interested stakeholders and shall explore the role of renewable natural gas in the  
28 context of both regulated gas and electric service providers. The docket shall also explore the roles

1 and definitions of different kinds and sources of renewable natural gases to determine which gases and  
 2 sources the Commission should consider renewable.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.


5  
 6   **DISSENT**  
 7 CHAIRMAN BURNS COMMISSIONER DUNN COMMISSIONER KENNEDY

8  
 9    
 10 COMMISSIONER OLSON COMMISSIONER MARQUEZ PETERSON



11 IN WITNESS WHEREOF, I, MATTHEW J. NEUBERT,  
 12 Executive Director of the Arizona Corporation Commission,  
 13 have hereunto set my hand and caused the official seal of the  
 14 Commission to be affixed at the Capitol, in the City of Phoenix,  
 15 this 17 day of December 2020.

16   
 17 MATTHEW J. NEUBERT  
 18 EXECUTIVE DIRECTOR

19  
 20 DISSENT 

21  
 22 DISSENT \_\_\_\_\_  
 23 SMH/(gb)



SERVICE LIST FOR:

SOUTHWEST GAS CORPORATION

DOCKET NO.:

G-01551A-19-0055

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